BANK OF ENGLAND

Speech

Speech given by
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At the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House
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My Lord Mayor, Mr Chancellor, Mr Vice-President, Your Excellency, My Lords, Aldermen, Mr Recorder, Sheriffs, Ladies and Gentlemen:

Tonight's dinner is in honour of the merchants and bankers of the City of London. The merchants have not always seen eye to eye with the bankers. Exactly 300 years ago, an anonymous merchant published a pamphlet attacking the Bank of England's power to set interest rates and bemoaning its consequences for the constitution of this country: "the Bank … is in the hands of [those] who are not liable to any Personal Penalty. The Government will be … in the Hands of the Bank, and may be undone either at long run by being supply'd at too dear a Rate, or at once by not being supply'd at all". These days, merchants are more concerned about the effect of interest rates on their businesses than on the Government. And the Government has asked the Bank to set interest rates to maintain stability by meeting the inflation target. So relations between merchants and bankers are now more cordial. Lord Mayor, thank you for again bringing us together.

Since we last met in this magnificent room, the General Election returned the Government to office for a record-breaking third time. And since 1997 there have been nine Lord Mayors, eight French finance ministers, seven shadow Chancellors, six Italian finance ministers, five Secretaries of State for Trade and Industry, four US Treasury Secretaries, three permanent secretaries in HMT, two Governors, and, yes, just one Chancellor. Chancellor, we congratulate you on your longevity in office.

You have certainly changed the Treasury. But I rather regret that you have not suggested moving the Mansion House Dinner back to its more traditional date in October, where it was from 1931 to modern times, suitably halfway through the financial year and midway between Budgets. When the Budget was moved – temporarily – to November in 1993, the dinner was switched to June. But for some reason it did not move back to its Autumn date when the Budget reverted to the Spring.

The idea of a June or July date had been mooted on several earlier occasions, but had not found favour. In early 1949 a senior Treasury mandarin wrote to the Deputy Governor:

"The annual bean-feast for the Merchants and Bankers won't be able to take place in October" [this showed foresight since sterling was devalued in September of that year]. "They are thinking of July as an alternative…But I don't like it very much…In July, Parliament is just about to rise at the end of a long and exhausting session; everybody…is panting to get away on holiday; and the financial year is only about a quarter of the way through. In October, by contrast, our holidays are behind us, we are just about to settle down for the winter's work, and enough of the financial year has passed to make it reasonable for the Chancellor to say something about the way in which things are going".

So how are things going? Let me say a few words about the Bank's responsibility for **communication** in three areas: monetary policy, the management of financial crises, and the oversight of payment systems.

Communication with financial markets and the general public is a key part of the responsibilities of the Monetary Policy Committee. In our speeches, the *Minutes* of our monthly meetings and our quarterly *Inflation Reports*, we strive continuously to stress the importance of uncertainty in the economic outlook. We try to explain both what we think we do know and – as importantly – what we don't know. Judging the balance of risks is very different from pretending to foresee the future. Looking ahead is a necessary part of our policy process because of the lags between decisions on interest rates and their impact on spending, output and, finally, prices. But we must remain conscious of the limitations on our ability to forecast the future path of the economy. The certainty with which many commentators present their views is, frankly, bizarre. Too often, forecasters seem to be the unfathomable in pursuit of the unpredictable.

The essence of monetary policy is to reduce uncertainty by anchoring inflation expectations. Most discussion of monetary policy sees policy as a series of discretionary decisions on interest rates. But monetary policy is more than that. It is a regime for setting policy, and it is the regime, rather than individual decisions on interest rates taken month by month, which anchors inflation expectations to the 2% target. A key reason for having an explicit target for inflation is to make it easier for businesses and households to form their expectations of inflation. Interest rates will be expected to respond to developments in the economy in a predictable way.

The MPC tries to make monetary policy predictable not by giving hidden signals and subtle clues in speeches – including this one – as to where interest rates will go next, but by explaining our interpretation of the data. We do not make up our mind about interest rates before the policy meeting takes place, and we do so only in the light of an appraisal of all the information available then.

So what do we make of the data? Our most recent assessment is contained in the MPC *Minutes* published this morning. The starting point is that inflation is very close to target and the economy is still growing at a rate not far from its long-run average. But final domestic demand growth has weakened for five consecutive quarters. Some easing was desirable in order to bring about a rebalancing of the economy. But inevitably it increases the uncertainty about whether net external demand will compensate for weaker domestic demand. It is unlikely that growth will be as smooth in the future as it was over the past decade.

Those concerns have been fuelled by the sharp slowing of consumer spending in recent months. The weakness in sales of goods on the high street has been marked. Nevertheless, consumption of services appears, at least so far, to be more resilient. So it is possible that we are seeing a temporary slowdown in spending, although we cannot be sure.

The risks around that view are the key to policy. The main downside risk to activity and inflation is the immediate outlook for demand: consumer spending, business investment and exports. In particular, if the weakness in spending on goods were to spread to services then the slowdown in consumption growth would be more protracted.

The main upside risk stems from signs of cost pressures on business. Import prices, which had been falling for several years, are now rising. And it is still unclear whether the rise in inflation from 1.1% to 1.9% in just six months reflected generalised demand pressures or purely temporary factors.

Judging the balance of those risks is a difficult task. What matters most is that the Monetary Policy Committee will react promptly to whichever of these risks appears to be materialising in the months ahead, and will continue to communicate its thinking regularly to both the markets and the wider public.

Communication in times of financial crisis is very different. The irregularity and, we hope, the infrequency of crises precludes the strategy of regular communications appropriate to monetary policy. Nevertheless, it is important that we communicate to you and others in the financial world how such crises would be managed. Although we try to assess and communicate financial vulnerabilities (in the *Financial Stability Review*, for example), no system of monitoring can spot all threats to the stability of the financial system as a whole, nor hope to avert all crises. Managing crises is the responsibility of the Standing Committee comprising the Treasury, FSA and the Bank. Contingency planning for such events is essential. Within the Bank our arrangements have been tested in a series of exercises involving studies of past crises, such as the failure of Barings in 1995, as well as hypothetical new scenarios. I can assure you that the tripartite arrangements exist not only on paper but in an agreement on how minute-by-minute co-ordination of the operations of the Bank and FSA would work during any crisis. That is something which Callum McCarthy and I have been keen to promote, and the details will be announced in the Autumn.

A third area in which communications are an important policy instrument is the Bank's oversight of payment systems, a responsibility mandated by the 1997 Memorandum of Understanding. Since the 18th century, the Bank of England has been at the apex of the payment system in this country, largely as the provider of the asset in which other financial institutions settle – central bank money. Today, one of our key roles is to ensure that UK payment systems are resilient in the face of shocks – such as the unexpected default of a major institution or a significant operational disruption. The Bank has increased transparency about its assessment of risks to UK payment systems through the publication of the first *Payment Systems Oversight Report* earlier this year. Transparency should help to reduce risks by prompting remedial action by the operators of and participants in the relevant payments systems. Like the *Inflation Report*, the new *Oversight Report* aims to put the Bank at the cutting edge of best practice.

There are several areas, identified in the *Report*, where further remedial action is needed. Last year I mentioned the need to reduce settlement risk in the major UK retail payment systems. Since then encouraging progress has been made. And in the Payment System Task Force, chaired by the OFT, there is now agreement to introduce a same-day clearing service for electronic payments made by individuals and businesses. That should deliver both lower risk and greater efficiency for the general public. I very much hope that one year from now we will have seen real progress towards implementation.

So in three areas – determining monetary policy, limiting the damage from crises, and overseeing payment systems – communication is at the heart of the work of the Bank of England.

There was a time when communication between the Bank and the City was simpler: when one of the main drivers of the demand for credit was the direction of the wind, easily observed by all, which indicated when conditions were favourable for ships to enter or leave the port of London. Although communications have evolved a great deal since those days, the Bank, believe it or not, still has a weather vane in its Court Room and shipping remains important to the City. One half of world seaborne trade may be unloaded in Asia, but almost one half of the ships involved are bought, sold and chartered in London by members of the Baltic Exchange.

Lord Mayor, you have made "Maritime London" the theme of your mayoralty, and how appropriate in the year in which we celebrate Nelson's victory at Trafalgar. Indeed, if this dinner had been held in October we could have celebrated that great victory with the merchants and bankers whose predecessors helped to finance it.

Tonight all of us here would like to pay tribute to your work since you became Lord Mayor, and to thank both the Lady Mayoress and yourself for the splendid hospitality which you have extended to us all this evening.

So I invite you all to rise and join me in the traditional toast of good health and prosperity to "The Lord Mayor and the Lady Mayoress".

ENDS