Bank of England

Mark Carney, Governor - Speech
24th October 2013

Lionel Barber,
Editor Financial Times:

Good evening. It's my great pleasure to introduce our guest speaker Mark Carney, the Governor of the Bank of England. Mr Carney as you know is also Chairman of the Monetary Policy Committee, the Financial Policy Committee and the Board of the Prudential Regulation Authority. And in case you were wondering what he actually does in his spare time, he's Chairman of the Financial Stability Board, which coordinates financial regulations worldwide.

Mr Carney is a native Canadian, born in Fort Smith, Northwest Territories. He received a Bachelor's Degree in Economics from Harvard and completed a Masters and Doctorate in Economics from Oxford. Sadly, he did not make the obvious next move in his career and join Ed Balls, Stephanie Flanders and other distinguished members of the economics leader writing team at the FT.

Instead, he joined Goldman Sachs, working in London, Tokyo, New York and the Toronto offices. And after serving at the Bank of Canada and the Ministry of Finance he became Governor of the Bank of Canada in 2008. His timing was perfect because it was just right in the middle of the global financial crisis.

Now the Canadian economy outperformed its G7 peers during this crisis, thanks in part to decisive policy choices, including what we now know as forward guidance on interest rates.

So Mr Carney is a cosmopolitan, an economist, and a man of action, a rare combination. Governor, we look forward to your remarks.

Applause

Mark Carney, Governor: Thank you very much Lionel, thank you all for being here. I think when you hear this speech you'll realise why I didn't apply to be a leader writer at the FT - over the next 45 minutes I will now expand - no it will be a little shorter than that, but this is central bank stuff, not the thrilling prose of the FT.

I'd like to thank all of you for being here, thank my colleagues the governors, fellow governors of the Bank of England, Charlie Bean and Andrew Bailey for being here, pay testament to the service of Paul Tucker over the last 33 years. And the three of us Charlie, Andrew and myself wait in breathless anticipation for the arrival of Sir Jon Cunliffe in a few weeks' time.

See Governor's speech : http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech690.pdf

Applause

Lionel Barber, Editor, Financial Times: Well, ladies and gentlemen, I think we can all agree, Governor you've got the job. We're going to be - in the spirit of the Financial Times in 2013 both analogue - I will be asking a couple of questions of the Governor - and then digital in that we will be opening questions to the audience.

Now Governor you've given a vote of confidence in finance, qualified of course on adequate regulation and making the global finance, in your words, robust but resilient. But I am tempted to quote your countryman, your distinguished countryman, Wayne Gretzky, the ice hockey player, who I believe said that - "It's important when you're playing ice hockey to skate where the puck is going, not where the puck has been." And my question is whether, for all the best intentions regulators around the world, not just at the Bank, are looking backwards and fighting the last war on excess leverage, etc., rather than looking to the next crisis?

Mark Carney, Governor: First, I'm very impressed by the Wayne Gretzky ...

Lionel Barber,
Editor Financial Times: I've been working on that one.

Mark Carney, Governor: ... truly cosmopolitan. I think I'd say a couple of things. First there are a couple of basic lessons from finance, and the first is that ultimately leverage gets you in trouble. So that lesson of warfare and finance is always valid. Related to that is - problems soon arrive when one sees sustained above trend borrowing by any mechanism.

But I would say, without going into too much detail, because we don't have that much time, that there is a huge swath of work that I didn't touch on which relates to the shadow banking sector. And the advantage of it is it's not - it's looking at economic function, as opposed to going to specific types of institutions.

So it's about whether there are collective investment vehicles, whether there are vehicles that facilitate credit intermediation, such as insurance, credit insurance, monoline type insurance, but such as, as opposed to just going back to fix the monolines, or just going back in the first example to fix the CIVs, which of course don't really exist any more.

And so that swath of work, which is going to mature over the course of this year, is the Gretzky work, if you will, it's going to where the puck isn't yet. But, in part because of what we're been doing in applying the lessons, the core lessons of warfare - to mix my analogies - will be encouraged by the activities. So the activities we're doing on the reform side actually encourage some of the other …

Lionel Barber,
Editor Financial Times: So no hiding place for shadow banking?

Mark Carney, Governor: No, no and the objective is to turn that from - in our parlance - from shadow banking to market based finance. And one of the themes of what I was trying to say is that good markets are transparent. They have robust infrastructure, they are structured in a way that is continuous, so they aren't discrete. And unfortunately, much of shadow banking doesn't meet those criteria and so we will move it in that direction.

Lionel Barber,
Editor Financial Times: Let me phrase the question somewhat differently. Some politicians in this country have identified what they see as a trade-off between greater stability (more capital) and growth, that is more leverage. Now do you accept that trade-off or do you think you've find a way of resolving the tension?

Mark Carney, Governor: I've been very fortunate in my timing because my colleagues - and Andrew and Charlie are here today representing them - and they're very much part of these decisions. They recognised, through the FPC of the Bank of England, that the trade-off is not there if the core institutions are inadequately capitalised. And through a series of efforts, most notably earlier this year where they got a lot of noise around them from maybe some of those same politicians you're referring to.

Lionel Barber,
Editor Financial Times: You're referring to the comments about the 'Capital Taliban?'

Mark Carney, Governor: Well you can refer to them, and I can just leave it out there in the ether. But the core point was that unless financial institutions are adequately capitalised, they don't go out and search new business. They're looking over their shoulder; they have become fundamentally risk averse in part because their investors, their creditors and they themselves know this. It is interesting that - and I don't think this is just a correlation, I think this is a causation - that once the core of the system here reached the FPC's 7% threshold, which is a fairly demanding threshold, once it reached that associated with leverage, then we've started to see a growth again in credit.

Lionel Barber,
Editor Financial Times: And do you believe that this argument actually is being resolved by the numbers on the ground, the data that Britain has turned the corner in terms of its economic performance?

Mark Carney, Governor: I think - and Charlie mentioned this yesterday, I certainly agree - that one of the reasons to think that there could be some sustainability, some traction in the recovery, is that the core of the financial system here has gotten a lot better. I won't say it's fully healed, but gotten a lot better. And the rebuilding of capital is a big element of that.

Lionel Barber,
Editor Financial Times: But just a year ago I think there was a consensus even at the Financial Times that the financial system and the transmission mechanisms for credit were essentially broken. Do you believe that's still true?

Mark Carney, Governor: It's substantially less true, certainly not broken. It's not operating as well as it ultimately will, the financial transmission mechanism, that's why we still have Funding for Lending in place, that's why in some respects why we still have exceptionally accommodative monetary policy. That healing process still has to proceed for a while. But what has changed is that at the core of the system, the core of the system is functioning.

I'll make one final point if I may. One of the things we shouldn't measure though, for a sustainable recovery in the UK is an aggregate growth in credit. This is still an economy where there is a large and desirable deleveraging of the economy. So we're not necessarily going to get the aggregates growing. What's important is that the new businesses and the young families are able to get access to credit.

Lionel Barber,
Editor Financial Times: So was that a full-throated endorsement for Help to Buy?

Mark Carney, Governor: That was - boy I didn't touch it there at all - it was a full-throated endorsement for Funding for Lending and for the FPC's effort to fix the core.

Lionel Barber,
Editor Financial Times: And bankers are telling me that Funding for Lending really is actually making a difference - much maligned in certain quarters at the beginning.

Mark Carney, Governor: I think it makes a difference for those - it makes a difference because it, plus a few other things have substantially improved the overall funding markets. Look, funding has come down 250 to 300 basis points, at the core of the system funding rates. That's helped very much by Europe, but Funding for Lending played an important role in that.

Lionel Barber,
Editor Financial Times: Now you did give a full-throated endorsement of the role of the City of London, but figures this week and the Deputy Governor, Charlie Bean, cited the relatively poor, slightly worrying performance on the export of financial services from

the City. Can you explain what's going on or is this is a temporary phenomenon?

Mark Carney, Governor: Well there's two things happening. One is that the overall level of cross-border capital flows - and I touched on it briefly in the speech - have gone down substantially since the crisis, down more than 50%, almost 60% on some measures; that's pure cross-border flows. A lot of that is in Europe, but there's more transatlantic and developed, emerging market. Some of that, in fact a substantial proportion of that, is actually desirable. This was short-term, wholesale finance between banks in Europe; we know how well that's worked out. It was structured products from the US back into Europe as well - again that's not something that's necessarily desirable.

What it has shrunk down into though is a core of more sustainable flows, which we would expect to grow from there. Now whether or not UK institutions maintain market share or increase market share is up to them. What we have to do is organise the system in a way that ensures domestic stability. And we think we can do that.

Lionel Barber, Editor Financial Times: Now before I open questions, no conversation with the Governor of the Bank of England and the Financial Times would be complete without some reference to Europe. You studiously avoided any reference, Governor, to the question of banking union. Do you believe that if banking union does go ahead, that the role of the City is secure, that we will not be discriminated against by that deeper integration in Europe?

Mark Carney, Governor: Well it goes to international engagement, it goes to engagement at European level. It's something that all the governors are very focused on; it's one of the advantages of Jon Cunliffe coming in. I myself, you know, I have to say the first outward phone call I made was to Mario Draghi as Governor, the first meeting I had was …

Lionel Barber,
Editor Financial Times: Because you took over from him as the Head of the FSB.

Mark Carney, Governor: … the Head of the FSB, one of my first meeting was with Michel Barnier, I am Vice Chair of the SRB, I go to the General Council meetings. We - and this is true of my colleagues in their settings as well and it will be true up and down the chain in the Bank of England. And the way to make this work is to be engaged. And that means we have the dual structure where we are the supervisor here, we are the macroprudential regulator here. We make the SRB work, we make the General Council at the ECB work, we make the Commission work in a way that suits UK financial services. But the only way to do that is to be engaged.

Lionel Barber,
Editor Financial Times: So no empty chair policy being pursued by the Governor of the Bank of England. The first question from the floor is Ana Botin, please do stand up.

Ana Botin, CEO Santander: Thank you. So Mr Governor, my question - you won't be surprised - relates to regulation and growth. You alluded to many of the reforms that have either happened or are being implemented. But being very disciplined, I will obey what the Editor suggested in terms of being forward looking.

So my question would be, what sense checks, if any, has the FPC put in place, or would you recommend that the FPC put in place, so that as we go into very important months ahead where all the details of the ICB and PCBS recommendations are going to be finally detailed? That we both get what policymakers and I think all of us want, which is robust legislation, but that we don't get - and I'd say two things -

one is we don't disadvantage UK Plc, and specifically our small and medium sized companies that obviously could be affected by these structural reforms. And second, and very importantly, that the investability of UK banks is again good, and vis-à-vis not only US and German banks, but also thinking about the financial sector vis-à-vis other sectors, as we go through these very important structural reform details that our friend Bill Winters and others have been working on?

Mark Carney, Governor: I think a couple of things, one is we will, and we have commented on the - as you know on the PCBS - the current set of recommendations they're working through the legislation and that's in the public domain. Obviously we, the FPC, but the broader Bank, the PRA itself, and the broader Bank are taking a clear focus on the prudential aspects, both micro and macroprudential.

We have secondary objectives, which are to support strong, sustainable and balanced growth, effectively in the cases of both and we take those very seriously. So it's prudence, but in the context of having satisfied that, we support it. And so this isn't, to use another phrase where you were drifting towards, this isn't about stability of the graveyard; it's about appropriate levels of resilience in the system.

Now a resilient UK banking system is going to perform better, I mean ultimately investors will make those determinations. But again if you look at - since the much maligned, but correct, in my opinion certainly, FPC effort, you know price to book ratios of UK banks have gone back towards unity from heavy discounts. Things that make this system work, make it work better at the core are ultimately going to change the sharp ratio; I can use it with you because of investing in UK financial institutions.

But we're conscious - we're absolutely conscious it's a macro institution ultimately, the Bank of England, and we're very conscious of getting that balance right so that once we've achieved those appropriate levels of resilience, that it's not overdone. So I'll leave it at that.

Lionel Barber,
Editor Financial Times: Thank you Governor, Evelyn de Rothschild.

Evelyn de Rothschild, Financier: Mr Governor, the FT has been through many financial crises and survives today in a remarkable way. I would just like to point out and ask you a question. Five years ago when we had our financial crisis, I think it's fair to say that the general public lost confidence in the banking system. That confidence has been eroded; it's not only been eroded in the United Kingdom, Europe and the United States.

Can you answer me, on the basis that you think confidence is coming back, and do you believe that central banks generally worldwide should be more open and more publicly aware of the average person who tries to open accounts and has confidence in the bank - not only your Bank Sir, but everyone's bank?

Mark Carney, Governor: Yes, well I think you're absolutely right there's been a loss of confidence in banks; there's been a loss of confidence in the system, and higher than that there's been a loss of confidence between authorities in the system or trust between authorities in the system. And we've been going through a process of trying to build that back up.

What's necessary - and confidence you know - with the Montek Singh Ahluwalia, the most famous version of this which is it grows with the rate of a coconut tree and falls with the speed of the coconut. We've had the fall and now it's got to be grown back up. How do we nurture it?

Capital is part of it, that's obvious. I think capitalism is part of it, actually making the system fair, so ending 'too big to fail' is a large element. There is a need - I think compensation has been a big element from a public perspective. I would suggest that - as important as some of the compensation, the initial compensation reforms have been - so to get proper alignment of employee incentives, investing in claw backs, etc., - as important as those have been, compensation structures can't ultimately replace culture within an organisation and so institutions really need to get their culture right and in the end their core values right.

And that ultimately goes back to the end customer. So understanding that without a prosperous real economy, prosperous customers - the institution itself isn't going to prosper. So they have to be speaking to these people and hearing the messages.

So I'll finish by just saying, look we - I think central banks do recognise, certainly the Bank of England recognises, this fundamental hit to confidence. And also I'll say one thing and just personalise it - it used to really strike me when I would come to the UK, to a slightly lesser extent to the US, from Canada, as Governor of the Bank of Canada, how different things were, how different the attitudes were towards the institutions, how much confidence had been hit. And I don't know if it was fear, but it was certainly loathing that had replaced confidence in that regard, and it gives a sense of the scale of the challenge.

Lionel Barber,
Editor Financial Times: Next question, a question from the audience, yes, Frances.

Frances O'Grady, TUC: Thanks very much Lionel for the free advert as we walked into the hall. Governor, it's good to see the Bank taking account of unemployment in its assessment of the economy. But isn't counting numbers in and out of work a bit crude? Shouldn't we also be looking at the record number of part-time workers seeking more hours and of course what's happening in terms of people's real pay and living standards?

Mark Carney, Governor: Let me say this, I mean certainly in terms of our guidance we take into account unemployment. The unemployment rate is the, as you know, the threshold for a reconsideration of monetary policy, whether or not we would adjust our overnight rate. But we've tried to make very clear that we look at a much broader range of indicators both in terms of slack in the labour market, but more broadly slack in the economy.

And when the economy gets to that staging post of 7% we will look, and we do even today, look at other factors such as the proportion of workers who are working part time but want to work full time, which is in the upper teens and used to be substantially lower. We look at hours worked. And what we've seen over the course of the last year is that there actually has been a steady increase in the amount of hours worked for people who are working. There is a revealed preference for people to work longer.

And unfortunately that may relate to what's happening with wages and underlying wage pressures, which are very low at the moment. It may also have to do with the shift of employment from the public to the private sector, so we look at those factors. And we'll also look at other factors in terms of proportion of long-term unemployed and whether or not those workers can come back into the market.

So we do look, and we will continue to look, at a very broad range of labour market indicators to get a true indication of what the degree of slack is in the labour market and as a consequence what that means for activity and inflation. And remembering in all of this that, while we are using the unemployment rate as a threshold to then take stock, we are above and at the beginning and the end inflation targeters, and our job is ultimately about getting inflation back to the 2% target on the appropriate horizon.

Lionel Barber,
Editor Financial Times: Ladies and gentlemen, I'm very sorry, but there is a very tight timetable that we're on. The Governor is going to give a press conference. Evelyn in recognition of your request that the Bank should be a little bit more open.

But I would just ask everyone who's come tonight - and I should have thanked you from the outset for coming, it's an extraordinary gathering of people here tonight - to thank the Governor for giving us a really interesting lecture. He's covered an enormous amount of terrain, note I don't say battleground, and we're all extremely grateful, including at the Financial Times. Thank you, Mr Governor.

Applause

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