New prospects for money – speech by Andrew Bailey

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Speech

I want to start by welcoming the Chancellor's announcements this evening aimed firmly at encouraging investment in the productive economy. Since the financial crisis fifteen years ago we have seen potential output growth fall in many economies, the UK included. A sustained and robust improvement of the supply side of the economy is the only means to raise productivity and thereby the standard of living in a way that lasts the test of time.

In pursuing supply side improvements, we must also respond to recent events in a way that recognises the need to diversify our supply chains and make them more robust, but achieves diversification without abandoning open and competitive markets and free trade. We will get the best outcomes by pushing back against economic and financial fragmentation.

I spend time meeting businesses with the Bank's network of Agents around the UK, and I am left in no doubt that there are many opportunities for successful long-term investment, and that we must take up these if we are to respond to challenges and opportunities such as the transition to net zero, digitalisation and artificial intelligence.

But as you will understand, my pre-occupation at the moment is inflation. Currently at 8.7% in the latest data, consumer price inflation is unacceptably high, and we must bring it down to the 2% target.

The UK is not alone in this. There is currently a popular saying among central bankers, from the Danish philosopher Soren Kierkegaard, which, to paraphrase slightly, is that life can only be understood backwards; but it must be lived forwards. This is an important lesson as we do what is necessary to bring inflation back to target.

Looking back at all that has happened in recent years, the UK economy has been hit by a series of external inflationary shocks: higher goods prices in global markets owing to supply bottlenecks created by the pandemic; and higher energy and food prices following from Russia's war on Ukraine and its people.

Looking ahead, UK headline inflation is set to fall markedly over the remainder of the year. This largely owes to lower energy prices as last year's substantial increases drop out of the annual calculation. Food prices should fall too as lower commodity prices feed through to prices in the shops.

However, while the level of economic activity has failed to grow beyond its pre-pandemic level on a sustained basis, the UK economy has shown unexpected resilience in other ways in the face of these substantial – in some cases unprecedented – external shocks.

Unemployment is at 3.8%, right at the bottom end of experience in modern times, and the economy has avoided a recession thus far.

This is a good thing in many ways. No one wishes to see unemployment higher or growth weaker. But the interaction of above-target headline inflation with labour market tightness and demand pressure in the economy has made underlying developments in goods and services price inflation more sticky than previously expected. Both price and wage increases at current rates are not consistent with the inflation target.

In the face of these inflationary pressures, monetary policy has been tightened. Over the last twenty months, we have raised Bank Rate by nearly five percentage points. Some of that tightening is still to come through the policy pipeline, and we expect underlying inflationary pressures to recede as headline inflation falls. But the Monetary Policy Committee is monitoring developments – in particular, those in the labour market, in wage growth and in services price inflation – to assess whether pressures are proving more persistent.

To draw on Kierkegaard, we make our decisions drawing on the evidence we have as a guide to the future. At the last MPC meeting, that pointed to the need for further policy tightening. We are about to draw that evidence together again, as we do around every six weeks. It is crucial that we see the job through, meet our mandate to return inflation to its 2% target, and provide the environment of price stability in which the UK economy can thrive. This is the best contribution monetary policy can make to the prosperity of the United Kingdom.

Returning inflation to target is so important, not least because people should trust that their hard-earned money maintains its value. While that is our pre-occupation at the moment, living forwards in a time of technological innovation also means that we need to secure the value of money in a different way. The future of money is the subject for the rest of my time.

I am going to start by setting out two important foundations of safe money, on which the economy depends and in which the public can trust. These may sound obscure, but they're fundamental.

The first is called the 'singleness of money' while the second goes under the term 'finality of settlement'. Together, these two ensure things happen that we largely take for granted. One is that wherever we hold our money – in bank accounts, notes and coins etc – we can be assured that it all has the same value – the pound in my bank account equals the pound in your account. In other words, money is exchangeable at par value. I will come to the case of what happens when a bank fails. The second foundation – finality of settlement – means that when we pay for something we can rest assured that it actually has been paid for.

These may seem like obvious things that we take for granted, but that is only the case because we have confidence in the basics of money. And that's what central banks look after. At the Bank, as well as monetary policy to maintain the value of money through low and stable inflation, we regulate banks, and payment and settlement systems, we issue bank notes and we operate critical parts of the payments infrastructure, all of which contribute to these two key principles of money.

There is a lot going on in the world of money, so let me set out some of these developments and where they may lead to.

Recent events – the failure of a number of banks in the US and in Switzerland, and the consequence here of the resolution of the UK subsidiary of Silicon Valley Bank – raised two questions over the singleness of money. As bank deposits are money, how far does it extend and what steps need to be taken to ensure confidence is maintained? An important qualification to what I said a few moments ago is that the setting of a deposit protection limit – £85,000 in this country – means that in the event of a bank failure, money held on deposit in a failed bank above that limit may not retain all its value. As was clear in March, what happens to the money of customers who hold over that limit – and therefore the extent to which that money remains singular – is less certain and depends on how a resolution is executed.

But is this sustainable in the event? We know now that the US authorities decided in the events of March that confidence in the singleness of money had to be preserved, and so they used something called the Systemic Risk Exemption for a number of banks to extend depositor protection which, in reality, means taking steps to ensure all of the funds lodged in those failed banks remained money.

The term systemic risk is important, because their concern was that a breach of the singleness principle for large deposits in one bank could lead to a widespread loss of confidence that it would hold in others.

In the UK, we were able to resolve the subsidiary of Silicon Valley Bank without having to put the principle of singleness to the test. But, the lessons are clear. We must when designing and implementing resolution strategies avoid any uncertainty over what will happen. We must have clear ground rules on the principle of singleness in the event of a bank failure. And so, it should be no surprise that the authorities are thinking carefully about this issue. It doesn't automatically mean all money is guaranteed, but we must ensure the rules keep up to date.

It is developments in technology – both our ability to make payments digitally and quickly without queueing at a branch and the speedier transmission of information about the perceived health of financial institutions – that has brought this issue into sharp relief. And

that is just one example of how technological changes can bring new risks and of course new opportunities.

Let me move on to crypto assets, as another example. These can take two forms currently. What is known as unbacked crypto, of the Bitcoin sort. And, so-called stablecoins – of the Tether, US Dollar Coin sort. The former have no intrinsic value and are highly volatile and best treated as extremely speculative investments. The latter, while used as the settlement asset for transactions in the crypto world, are not robust and, as currently organised, do not meet the standards we expect of safe money in the financial system. In particular, both fail the basic tests of singleness and settlement finality. They are not money.

Much more promising in my view is the prospect of enhanced forms of digital money which satisfy both tests. And this is perfectly possible and achievable.

Let me start with the question of what is such enhanced digital money? I use the word “enhanced” deliberately. Today, we have money which is entirely held in IT systems. I think enhanced digital is most conveniently defined as a unit of money to which there is the capability to attach a lot more executable actions, for instance contingent actions in so-called smart contracts, which could be simple or quite complex. But the key point is that the singleness of money is preserved, it’s the utility of money – what we can do with it – that changes not the money itself. Just to be clear, when we talk in terms of programmable money in this sense, we mean controlled and programmable by owners and users, not by prying authorities.

A second question is, are we therefore talking about central bank digital money? After all, central banks – via reserves – already provide forms of digital money to the financial system. So must all forms come through central banks? Not uniquely is my answer. There is no reason that I can think of which makes well designed enhanced digital money the sole preserve of central banks. But to achieve this will require engagement and innovation all round.

A third question is whether there is a future for enhanced digital money? The precise answer is that we don’t know, but then we never know the answer to this question precisely for new innovations, that’s the whole point about innovating. In my view, more likely than not the answer is yes there is a future for digital money. Moreover, we must avoid a failure of imagination. Inability to specify a very precise detailed use case today is not a good reason to believe there will never be one. There are stories of scepticism around the benefits to be expected from the iPhone, and going further back, railways.

So, who might issue this new digital money, and might we see innovation which streamlines and hugely increases the productivity of important parts of our financial

system? The answer to the second part is yes we could see major innovation and we should encourage it, no doubt.

In thinking about sources, we can think of the types of money in two ways. First, we can divide it by who issues it. Seen this way, there is commercial bank money – the deposits that households and firms make with banks and the loans banks make – and central bank money – the deposits banks make with the Bank of England, and the banknotes we issue to the public.

In terms of stocks of money, in the UK system commercial bank money amounts to around £3 trillion, and central bank money amounts to around £964 billion. And in terms of use, commercial bank money is used in 85% of payments made by the public.

Second, we can look at who uses money and divide up money into retail and wholesale varieties. It's not a very precise divide in the world of commercial bank money, but more easy to define in the central bank world. In our world, we have £87 billion of retail central bank money – the stock of bank notes in issue used by households and firms, and £878 billion of wholesale money, the so-called reserves held by banks on deposit, in electronic or current digital form, at the Bank of England.

So, how might this all change with new and enhanced digital money?

We are exploring the case for retail central bank digital currency, and we jointly lead a CBDC Taskforce with the Treasury. This is important work, and we are keen to hear views and engage widely throughout the project. We have recently concluded a public consultation which has, for us, attracted a record number of responses – over 50,000.

I welcome the large response to the consultation paper. The Chancellor and I have always been clear that the introduction of a retail CBDC would be a major step and that there should be a public debate about the future of money in the UK. We will review CP responses carefully, responding publicly in due course, and the feedback will be an important input to our work. And we intend that the public engagement and debate should not end there but should continue through our next phase of work, which will provide the foundation for a future decision on whether to go ahead or not.

We also welcome a wide range of views, all of which will inform how we take forward the next stage of work. Some of the responses indicate that retail CBDC can be a real breakthrough in the world of digitalisation. Others suggest concern about a desire by the authorities to reach into people's privacy which is absolutely at odds with what we should do, and indeed would. Incidentally, whoever painted “no to CBDC” on a motorway bridge, I can only apologise to the Cumbria Biodiversity Data Centre. Sorry.

From the Bank of England's point of view, our main motivation for a retail CBDC would be to promote the singleness of money by ensuring that the public always has the option of going into fully functional central bank money that can be used in their everyday lives. We have set out a number of arguments for why this might be needed in our consultation paper. But we do not yet know if we'll definitely need to do it – this will depend on how trends in money and payments play out.

Our work on retail CBDC does not alter our commitment that physical cash will remain available to any and all that want to use it. The Bank has made clear that we will continue to produce bank notes, and under the new Financial Services and Markets Act, the Bank of England and FCA will have new powers to ensure the future effectiveness, resilience, and sustainability of the cash system. Cash is here to stay.

Let me come on to the mix of money in the future. I don't think we should be using enhanced digitalisation materially to shift the mix of commercial bank and central bank retail money towards the latter. Commercial banks support credit creation and lending in the economy, and I do not wish to see this impaired. We want to encourage more thinking and action in the world of enhanced digital bank deposits – sometimes call tokenised deposits. So, yes, this is a call to action particularly to banks – don't leave central banks as the only show in town. That's not what we want. We may still think it is helpful to create retail central bank digital currency as an anchor for the singleness of digital money, which is why we are going ahead with our investigative work. We want to be able to have a genuine choice.

We may also get proposals to create digital money in the form of stablecoins, which could be issued by banks or non-banks. We will shortly set out proposals for regulating systemic stablecoins, under powers contained in the Financial Services and Markets Act 2023. Such stablecoins will have to meet the tests of singleness of money and settlement finality.

Finally, let me turn to the prospect of wholesale enhanced digital money, and talk briefly about what we are doing at the Bank. There is huge scope to revolutionise the productivity of important parts of the financial system, particularly in areas like settlement and custody.

Wholesale central bank money – accounts at the Bank of England – is an extremely flexible thing. It plays a major part in implementing monetary policy, preserving financial stability through its characteristics as the ultimate liquid asset, and every day it is the engine to achieve settlement finality in payments. Versatility is a good description. Wholesale finance is an area where in my view we can say with great confidence that we will want to encourage an expansion and enhancement of the use of wholesale enhanced digital money. As part of this, we want to maintain the ability for wholesale financial transactions to settle in central bank money, the safest form of money. So we recognise

that, should they be widely adopted, *tokenised* financial market transactions will require this ability too.

But as many in the payments world have told us, we are well on the way to enabling this innovation with the renewal of the Bank's Real Time Gross Settlement system, the largest infrastructure programme the Bank has undertaken, under the leadership of Victoria Cleland. This puts us in a very strong position to deliver solutions which can integrate central bank digital money in RTGS with tokenised transactions. We think this is the fastest and most efficient route to take.

Last month we migrated the wiring of RTGS with the outside world successfully. We have moved from copper to fibre optic so to speak. Can I thank all of the many firms involved in making this a success. You now have a much improved financial messaging system with the ability to transmit much wider data which starts to enable greater programming and enhance domestic and cross-border payments. Next year we will introduce the new settlement engine.

Our ambition does not stop there. This will create the platform for change and enhanced digitalisation. Last year we consulted on what industry would like to see next in terms of wholesale payment capability, and Victoria and her team are now working with industry to develop an ambitious world-leading roadmap of future payment innovations we will introduce in the UK.

This is all very exciting and puts us on the threshold of what can be major changes. So, let me finish with one thought. What the history of the City suggests is that there is a great capacity to move on from past successes and seize the opportunity to get out in front again. We have that opportunity again with the digital world, but we need to take it.

Now I said I was finishing, but I have one more thing to do.

[TOAST] The Lord Mayor and Lady Mayoress.

I am grateful to Jamie Bell, Sarah Breeden, Nick Butt, Victoria Cleland, Jon Cunliffe, Ed Dew, Andrew Gimber, Andrew Hauser, Robert Hills, Karen Jude, Ali Moussavi, Nick Mclaren, Tom Mutton, Matthew Osborne, Rhys Phillips, Huw Pill, Aniruddha Rajan, Vicky Saporta, Martin Seneca and Sam Woods for helpful comments and assistance in helping me to prepare these remarks.