Bank of England speeches

A short summary of speeches and *ad hoc* papers made by Bank personnel since 1 June 2014 are listed below.

Unemployment and the conduct of monetary policy in the United Kingdom

Ben Broadbent, Deputy Governor, August 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech752.pdf

Speaking to the Federal Reserve Bank of Kansas City's Economic Policy Symposium in Jackson Hole, Ben Broadbent discussed the role of unemployment in the conduct for monetary policy. He started by pointing out that, over the past century and a half, the only periods where there was a stable relationship between UK unemployment and wage growth were when there was a clear nominal anchor: the gold standard and, almost 100 years later, the inflation target. He continued by making two main points. First, during the inflation-targeting period and before the crisis, the UK monetary authority seemed to have mainly reacted to movements in output. He argued that this was in fact analogous to reacting to inflation developments because supply and cost growth appeared to move little so stabilising inflation and stabilising the real economy amounted to the same thing. Second, after the crisis as the Monetary Policy Committee (MPC) became more uncertain about its projection for potential growth, labour market data, even if with a lag, provided a valuable steer about the evolution of supply and inflation. It was in this context that the MPC conditioned its 'forward guidance' on the rate of unemployment. But as unemployment continued to fall and the supply of labour increased, the MPC started to consider wages as well. He concluded by saying that meeting the inflation target was still the ultimate objective of the MPC irrespective of the 'range of indicators' that would, as always, be considered.

Halfway up the stairs

Andrew Haldane, Executive Director and Chief Economist, August 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech751.pdf

In this article for the *Journal of Central Banking's* 25th Anniversary, Andrew Haldane considered some of the big questions on central banking. How have central banks evolved over the last quarter of a century? How has the crisis affected that evolution? And what lies in prospect for them over the next 25 years?

The article first discussed some of the key developments in central banking over the past century.

Andrew then considered two hypothetical future paths for central banks. The first is one in which the extraordinary measures taken over the recent crisis are returned to being tools for emergencies only. Here monetary, financial and regulatory policy would move to a more settled pattern over time. The other hypothetical path considered is one in which central banks' operational policies would remain expansive. In this scenario, their role in shaping the fortunes of financial markets and financial firms would likely rise.

The UK current account

Ben Broadbent, Deputy Governor, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech750.pdf

In a speech at Chatham House, Deputy Governor Ben Broadbent discussed why he did not view the UK current account deficit as posing an independent threat to UK growth. He started by recognising that if the global economy remains sluggish, it will inevitably be harder for an open economy like the United Kingdom to achieve both strong and balanced growth. But he explained that the composition of the United Kingdom's overseas balance sheet, the presence of a balanced net asset position and a floating currency reduce the threat from a large current account deficit. More specifically, he made three points. First, while the United Kingdom has run a current account deficit for most of the past 20 years, the stock of net foreign assets has been broadly unchanged. Second, the net asset position has some bearing on the empirical relationship between the current account deficit and subsequent rates of growth — it is a better indicator of crisis risk, and of the likelihood of the need for a sudden correction in the deficit, than the current account alone. Third, the United Kingdom's ability to earn more on its overseas assets than it pays on its liabilities may depend in part on the credibility of our economic policy. He then concluded that the United Kingdom has in place a hard-won policy framework that did not exist when it went through the traumas of the 1976 crisis, something that should never be taken for granted.

Making resolution work in Europe and beyond — the case for gone-concern loss-absorbing capacity

Andrew Gracie, Executive Director, Resolution, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech749.pdf

At a Bruegel breakfast panel Andrew Gracie summarised international and European Union (EU) initiatives seeking to end the notion 'too big to fail'. Gone-concern loss-absorbing capacity (GLAC) is effectively an internationalisation of the EU's concept in the Bank Recovery and Resolution Directive of a minimum requirement for eligible liabilities (MREL). The aim is the same: ensuring that banks' losses and recapitalisation needs can be addressed in a resolution. Andrew walked through the necessary ingredients for a resolution transaction — including use of a bail-in. GLAC, of sufficient size and quality and distributed appropriately within group structures, should enable authorities to resolve banks without recourse to public funds. Andrew concluded by highlighting forthcoming work on GLAC including technical standards on MREL due from the European Banking Authority and upcoming proposals in November from the Financial Stability Board.

Winning the economic marathon

Mark Carney, Governor, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech748.pdf

Speaking at the opening of the 20th Commonwealth Games, the Governor drew inspiration from great Scots, each of whom pointed to an essential ingredient of economic success.

William Paterson showed the need for a central bank. Its modern variant was a leading macroprudential institution, well equipped to face the challenges of promoting a balanced expansion.

David Hume demonstrated the virtues of free trade. The United Kingdom, already one of the most open economies, could help lead the development of new EU trade deals as businesses diversified their markets.

Adam Smith showed the importance of social capital. With a financial system that was a global good and a national asset, the United Kingdom was leading financial reforms to build a resilient global financial system with fair and effective markets at its core.

And finally, Olympic medallists Allan Wells and Liz McColgan showed the enormous pay-offs for hard work, dedication and perseverance. Winning the economic marathon would take similar determination. But the prize of a durable expansion was great and, if inspired by some of Scotland's many heroes, the United Kingdom would succeed.

The role of the leverage ratio and the need to monitor risks outside the regulated banking sector

Sir Jon Cunliffe, Deputy Governor, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech746.pdf

Jon Cunliffe discussed the two illusions exposed by the financial crisis: the capital illusion and the liquidity illusion. At the height of the crisis, the market simply did not believe the published numbers for bank capital adequacy. Together with reforms to the risk-weighted capital framework that suggested a need for an alternative gauge of capital adequacy: a leverage ratio, which did not rely on complex mathematical models. Prior to the crisis, lax regulatory standards allowed dealers to run with high levels of inventory and to accommodate easily shifts in the demand for market-making. However, that left them vulnerable to a change in conditions: when faced with severe stress, they were forced to withdraw from market-making altogether. Though tighter regulation could mean that market liquidity might start to fall away at an early point, the risk of a complete failure of market liquidity should be much reduced. One concern around the investment fund management sector is that heavy asset sales in times of stress could disrupt systemically important asset markets. In this respect it was currently quite puzzling that, when market participants seemed to be worried about the impact of regulation on market-making, liquidity risk premia seemed to be so compressed.

The capital adequacy of banks: today's issues and what we have learned from the past

Andrew Bailey, Deputy Governor, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech745.pdf

Andrew Bailey explained that the pre-financial crisis capital adequacy regime failed to provide the necessary protection. This was because the definition of capital set in Basel I included instruments that did not properly absorb losses, capital requirements were set too low in relation to the underlying riskiness of the assets, and banks were able to move risky assets into the trading book. Since the crisis the quantum and quality of capital held by banks has increased significantly. Key elements of the revised framework include: (i) a common definition of capital resources focused on genuine loss absorbency in going concern; (ii) capital buffers which vary depending on the size and nature of the bank and throughout the cycle; (iii) assessing capital adequacy using a combination of different approaches — risk-based

assessments, stress tests and a leverage ratio; and (iv) using internal models in a way that recognises their benefits while guarding against weaknesses and incentive problems.

The Bank of England's Monetary and Financial Policy Committees: guiding the economy towards a sustainable and safe recovery

Sir Jon Cunliffe, Deputy Governor, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech743.pdf

Jon Cunliffe explained how the Financial Policy Committee (FPC) and Monetary Policy Committee (MPC) work together to meet the Bank's mission of promoting the good of the people of the United Kingdom by maintaining monetary and financial stability. The MPC's role is to balance supply and demand in the economy to get the best outcome consistent with keeping inflation at target in the medium term. The FPC aims to preserve financial stability by ensuring the underlying financial system is resilient by identifying risks and taking action to prevent them crystallising. The stress test of major UK banks and the FPC's action on the housing market are two examples of how the FPC approaches its task. The point of the stress test is to explore how the financial system would cope with an unlikely but plausible combination of adverse circumstances. The FPC's actions on the housing market seek to make a period of stress less likely to occur in the first place. The measures should be thought of as insurance against a substantial increase and concentration in household debt that could make a crash more likely and more severe.

All Party Parliament Group on Insurance and Financial Services

Andrew Bulley, Director of Life Insurance, July 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech744.pdf

Andrew explained that the two most significant events affecting the life insurance industry in the past year had been the *Budget* announcement reforming the at-retirement market and the political agreement over Solvency II reached in November 2013. Andrew commented that the impact of the 2014 *Budget* announcements on the annuity market was still unclear but the effect was clearly likely to be significant. Andrew set out the Prudential Regulation Authority's (PRA's) attitude towards insurers' investments, saying that from a supervisory perspective, as long as insurers are able to understand and control the risks, and hold capital commensurate with those risks, the PRA does not take a view about the intrinsic and relative merits of individual asset classes. However, the PRA will require appropriate risk management of all an insurer's investments, not just those in infrastructure, because it is the performance and risk management of these assets that underpin critical payments such as pensions.

What do you think about when you think about a market?

Andrew Haldane, Executive Director and Chief Economist, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech753.pdf

In this article, published as a chapter in the book S*how me the money: the image of finance, 1700 to present*, Andrew Haldane reflected on the evolving nature of markets in modern society.

For more than 800 years, depositing and lending were the preserve of high street banks. Yet we may be about to enter an era where banking, too, becomes virtual. A world where payments are electronic and contactless, where lending is anonymous and digitised.

Yet trade relies on repeat business, reputation and trust. Trust is earned by individuals not automata. It is built not on transactions but relationships. And five years into this crisis, surveys reveal that banks remain at the very bottom of the trust league table. Regaining that trust is far from simple. Doing so may require us to rethink — or remember — what a market really is. Not an anonymised transaction, but a personalised relationship.

The UK productivity puzzle — a sectoral perspective

Ian McCafferty, Monetary Policy Committee member, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech739.pdf

In this speech, Ian McCafferty argued that recent weak aggregate productivity relative to pre-crisis has masked stark differences across sectors. Using new analysis which drew on Bank Agency intelligence, Ian showed that the contribution to the shortfall in productivity accounted for by sectors where the weakness is underpinned by predominantly non-cyclical drivers, such as stricter regulation and changes in business mix, is slightly greater than that of sectors where weak productivity primarily reflects 'demand-contingent' factors. Assessing the pace at which slack is absorbed requires a judgement on how much aggregate supply is likely to respond to increases in demand through a recovery in productivity growth. That 60% of the productivity shortfall appeared to be unrelated to the demand cycle suggested that a more rapid recovery than currently expected may be hoping for too much. Faced with uncertainty about the likely pace of absorption of slack, a prudent policymaker would want to start to remove some stimulus a little before the output gap is fully closed.

Spare capacity and inflation

Martin Weale, Monetary Policy Committee member, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech737.pdf

In a speech given to the Northern Ireland CBI in Belfast, Martin Weale addressed the question fundamental to the work of the MPC: what factors influence the outlook for inflation and what can we learn from studying them? He focused on two areas of the economy where inflationary pressure can build and which MPC action can influence. First, pressures within firms, affecting how they set prices. Second, pressures in the labour market, which affect wage growth.

Using data from the CBI's *Industrial Trends Survey*, Martin found that measures of firms' capacity utilisation — how intensively they use their existing physical capacity and labour — are poor predictors of how firms intend to change their prices over the next twelve months. Developments in wage costs, he found, are a far more accurate indicator for how firms will set prices and are the most important component of inflation in the economy overall. Martin therefore turned to focus on the impact of labour market slack on wage growth, and the conflicting signals that the MPC is currently receiving on the extent of spare capacity in the labour market.

The corridor of uncertainty

Andrew Haldane, Executive Director and Chief Economist, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech738.pdf

In this speech, Andrew Haldane discussed the latest developments in the UK economy and the role of monetary policy in supporting it. He argued that monetary policy makers on the MPC today face a dilemma. Should monetary policy hold back until key sources of uncertainty about the economy have been resolved? Or instead push forward to prevent leaving it too late?

Andrew discussed three sources of uncertainty, although noted that there are others. The first is that the economy could stall in its recovery. The second is that inflationary pressures instead take hold. The third concerns the financial side of the economy and the global appetite for risk.

Faced with these uncertainties, there is at least consensus among the MPC: any rate rise need not be immediate, that they are intended to be gradual, and that interest rates in the medium term are likely to be somewhat lower than their historical average.

Taking shadow banking out of the shadows to create sustainable market-based finance

Mark Carney, Governor, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech740.pdf

Writing in the *Financial Times*, the Governor noted that, as further progress was made in reforming the global banking system, and as risk appetite returned to financial markets, wider attention was beginning to focus on shadow banking.

The goal of the relevant authorities, led by the Financial Stability Board, was to replace a shadow banking system prone to excess and collapse with one that contributed to strong, sustainable, balanced growth of the world economy.

The reform programme to deliver this was composed of three elements. First, new standards to limit large exposures of traditional banks to shadow banks were being implemented, installing a firebreak between the sectors. Second, reforms were in train to make the institutions and markets at the heart of the shadow banking system more resilient. The third reform was to build a mature framework for monitoring and addressing financial stability risks arising from shadow banking.

There once was an ugly duckling

Andrew Haldane, Executive Director and Chief Economist, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech741.pdf

In 1931 Hugh Macmillan, a Scottish judge, chaired a commission into the problems of finance and industry. It unearthed structural fault lines in the provision of small and medium-sized enterprise (SME) finance — the so-called 'Macmillan gap'. In this article, Andrew Haldane highlighted that the Macmillan gap was re-exposed by the financial crisis and is now even more acute because SMEs now account for more than half of UK employment.

The stock of lending to UK SMEs has been falling for at least the past four years and the stock of lending to all UK businesses has fallen by a quarter from its pre-crisis peak.

One important way of improving matters is to make assessing SME creditworthiness easier. One way of achieving that is to create a database on companies' credit performance, as outlined in a recent Bank of England consultation document. Such a database could radically improve the information available and help transform the SME lending landscape.

The Governor's speech at the Mansion House

Mark Carney, Governor, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech736.pdf

The Governor began by noting that the economic recovery had steadily gained momentum and breadth over the previous twelve months. The challenge was to turn that recovery into a durable expansion characterised by balance in the housing market, the macroeconomy and the financial sector. To do that, the Bank would need to use all of its tools in as complementary a fashion as possible.

The Financial Policy Committee was considering using macroprudential policies to insure against potential vulnerabilities associated with the housing market, reducing the need for monetary policy to be diverted to address a sector-specific risk.

However, macroprudential policy was not a substitute for monetary policy, especially if it was used for insurance purposes. The need for internal balance — to use up wasteful spare capacity while achieving the inflation target — would likely require gradual and limited interest rate increases as the expansion progressed.

The Bank was also working with others in the public and private sector to restore balance in financial markets. As part of that, the authorities were already seeking to complete the job on ending 'too big to fail' and aligning risk and reward by developing a new remuneration code. The Bank was also leading a Fair and Effective Markets Review, which would ensure that everyone on every trading floor understood that dealing in a market meant serving the needs of clients, investors and customers fairly and effectively.

Managing cyber risk — the global banking perspective

Andrew Gracie, Executive Director, Resolution, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech735.pdf

Speaking at a British Bankers' Association conference on cyber, Andrew outlined why cyber matters from a financial stability perspective and the FPC's interest in the subject. He highlighted challenges that cyber poses compared to other operational risks. Andrew considered the Bank's work to address the FPC's recommendation; a systematic survey of the sector and CBEST, a new vulnerability-testing framework. CBEST brings together threat intelligence from public and private sources and enables firms to identify not only where their vulnerabilities lie, but the significance of cyber threats. In addition, firms need to co-operate to share information on potential threats and ensure effective co-ordination of responses to attacks. Andrew also noted that the Bank is unlikely to prescribe rules as to how firms manage their cyber risks. The threat is dynamic; our approach will be risk-sensitive and proportionate.

The Financial Policy Committee of the Bank of England; an experiment in macroprudential management — the view of an external member

Richard Sharp, Financial Policy Committee member, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech733.pdf

Speaking at the London School of Economics, Richard Sharp described the factors which led to the creation of macroprudential policy and, in particular, the FPC. He outlined the changes to the United Kingdom's financial regulatory structure in response to the recent financial crisis and the statutory objectives and powers given to the FPC. He then described some of the current key challenges for setting macroprudential policy in the United Kingdom, including: how different policy objectives should be balanced; difficulties in identifying and measuring potential risks at an early stage; and uncertainty about the effectiveness of the tools available to macroprudential policymakers, which makes it difficult to select and calibrate tools. The need to acknowledge the massive uncertainties in economics was noted. He concluded by outlining the risks he is currently concerned about, including the fragile UK economic position, and vulnerability to a snapback in rates and external shocks.

A missing tool against 'too big to fail'

Sir Jon Cunliffe, Deputy Governor and Dr Andreas Dombret, Board Member of the Deutsche Bundesbank, June 2014.

www.bankofengland.co.uk/publications/Documents/speeches/2014/speech734.pdf

In an article, published in *The Wall Street Journal* and co-authored with Andreas Dombret of the Bundesbank, Jon Cunliffe explained the remaining steps necessary to tackle the problem of 'too big to fail'. Revised capital and liquidity standards were already being put in place and over-the-counter derivative contracts had been mandated for central clearing. But the conditions were not yet in place to support effective resolution regimes for failed banks. Though legal frameworks to recapitalise failed banks by putting losses on bondholders had been agreed, an international standard was needed to ensure that banks had sufficient debt that could be safely 'bailed-in' at the point of failure. Work was progressing to develop such a gone-concern loss-absorbing capacity standard with the aim of having a draft standard in place by the Brisbane G20 summit in November. Banks' contracts also needed to be restructured to prevent a

disorderly unwind of contracts with close-out rights in a resolution scenario. That work was progressing jointly between the Financial Stability Board and the International Swaps and Derivatives Association.