



Institute
and Faculty
of Actuaries

QE and the inflation dogma Does it work and does it make sense?

Richard Silveira PhD, Deloitte

09 June 2017

Agenda

- Does the current mandate make sense?
- Is monetary policy a suitable tool?
- What did QE bring us?
- How will QE unwind?
- Is there another way?

Does the current mandate make sense?

09 June 2017

3

Does the current mandate make sense?

- Why does the BoE exist?

To promote the good of the people of the United Kingdom

09 June 2017

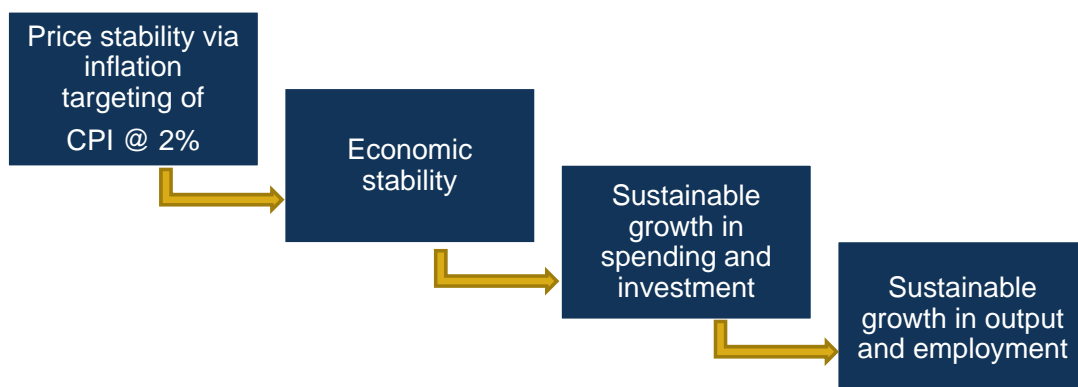
4

Does the current mandate make sense?

- Mandate is via monetary (price) and financial stability

The remit recognises the role of price stability in achieving economic stability more generally, and in providing the right conditions for sustainable growth in output and employment

Does the current mandate make sense?



Does the current mandate make sense?

- Why a single metric?
- Why 2%?

Is a single metric sensible?



Is a single metric sensible?



Necessary ***but not sufficient***
to achieve sustainable
economic growth



Institute
and Faculty
of Actuaries

09 June 2017

9

Is a single metric sensible?



Necessary ***but not sufficient***
to achieve sustainable
economic growth

So what else matters?



Institute
and Faculty
of Actuaries

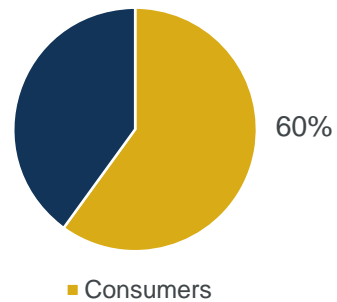
09 June 2017

10

Is a single metric sensible?



GDP is driven by consumers



Institute
and Faculty
of Actuaries

09 June 2017

11

Is a single metric sensible?



Pension *inflation*?

House price *inflation*?

Rental *inflation*?

Wage *inflation*?



Institute
and Faculty
of Actuaries

09 June 2017

12

Why 2%?

- The sweet spot – not too high, not too low
- Is 2% relevant now? Is a monetary supply issue?
 - Ageing population
 - Technology
- Behavioural factors – why it's still 2%
 - Status quo bias, experts' opinion, fear of regret, anchoring

Is monetary policy a suitable tool?

The central banker's toolbox

Setting base
rates

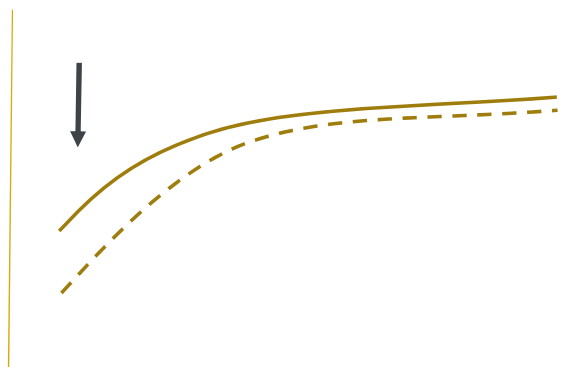
Macro-prudential
regulation



Quantitative
Easing (QE)

Open market
operations

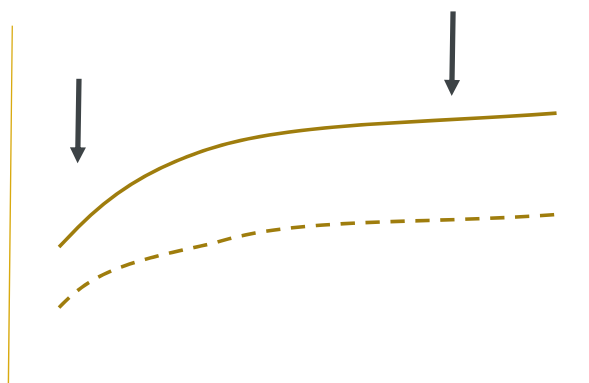
The central banker's toolbox



Set the base rate

Longer terms
affected through
expectation

The central banker's toolbox



Set the base rate

Longer terms
affected through
expectation

Add QE for direct
influence

09 June 2017

17

The central banker's toolbox

- Different tools, same intention
- Monetary policy is about
 - the yield curve i.e. the cost of credit
 - the relative value of risk-free and risky assets
- Lower rates to
 - increase aggregate demand through credit expansion
 - push capital into riskier assets

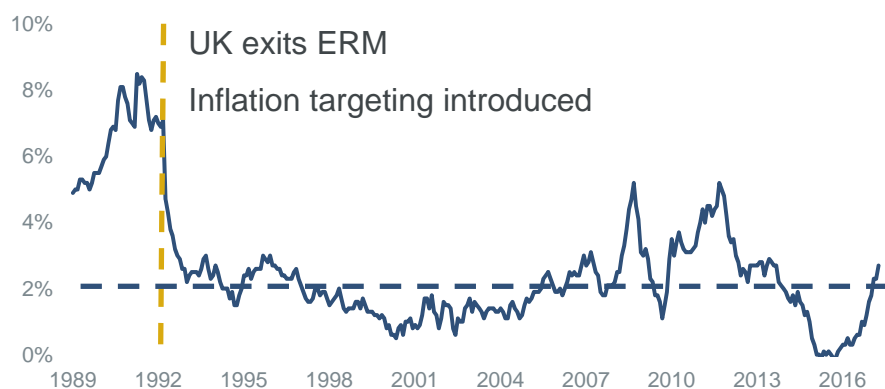
09 June 2017

18

Is monetary policy a suitable tool to lower inflation?

- Yes
- Effective since 1992
- Basis for current mandate
- Can raise rates to arbitrary level

UK CPI 1989 - 2017



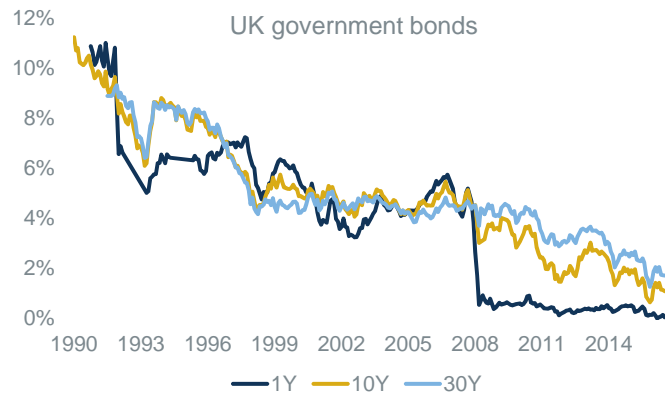
Is monetary policy a suitable tool to raise inflation?

- A blunt tool
- With costs
- And limitations

Limitations of monetary policy

- No guarantee cheaper credit is used
- No guarantee it's used for intended purpose
- The lower bound and diminishing returns
- Postpones the issue, doesn't fix it

A 30-year decline in interest rates



What are the alternatives to monetary policy?

What are the alternatives to monetary policy?

- Fiscal policy – tax, investment, spending
- Stimulates economy directly
- Not credit-driven -> upfront cost -> politically unpopular

09 June 2017

25

What did QE bring us?

09 June 2017

26

Background – March 2009

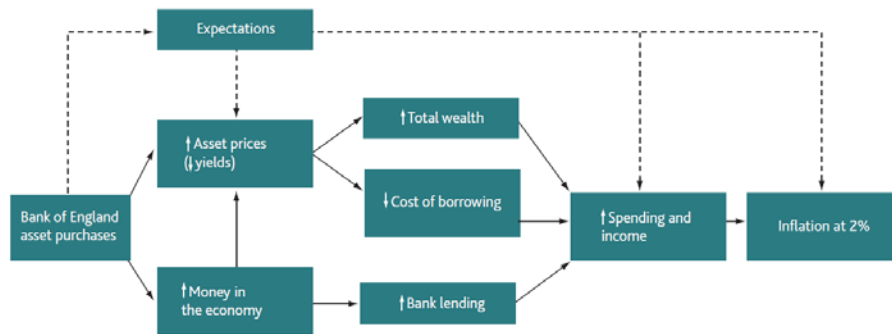
...the MPC judged at its March meeting that a further monetary loosening was required. In particular, it was concerned that nominal spending in the economy would otherwise be too weak to meet the inflation target in the medium term

Background – March 2009

The aim of quantitative easing is to inject money into the economy in order to revive nominal spending

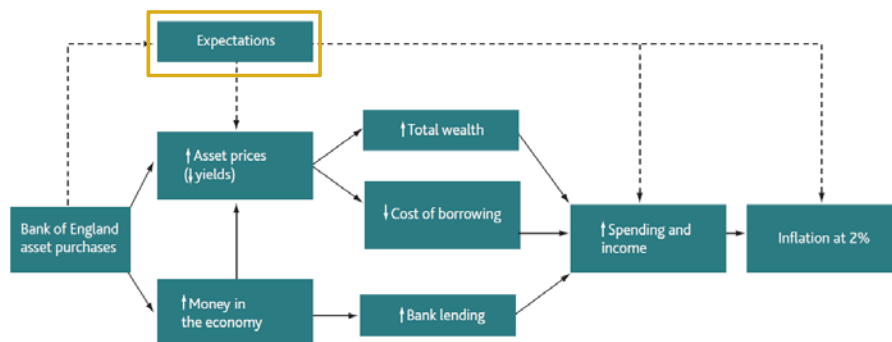
It should ultimately lead to an increase in asset prices and spending and therefore bring inflation back to target

Mechanism



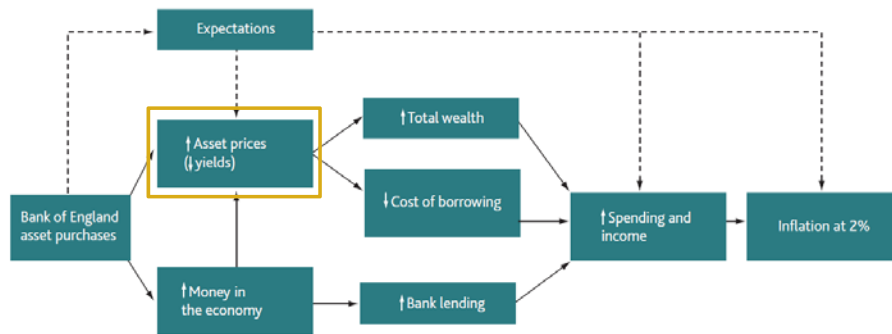
Mechanism

Asset purchases could have an important impact on expectations



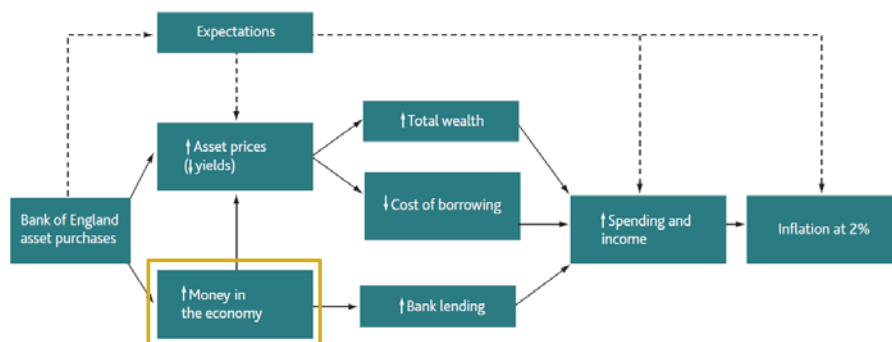
Mechanism

...higher asset prices increase the wealth of asset holders, which should boost their spending



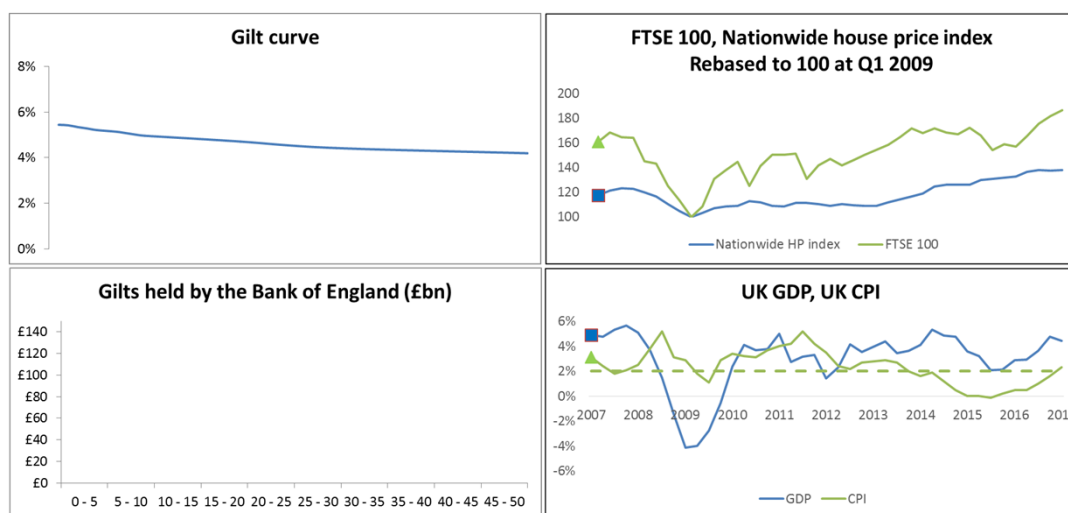
Mechanism

More bank lending to households and companies should help to support higher consumption and investment

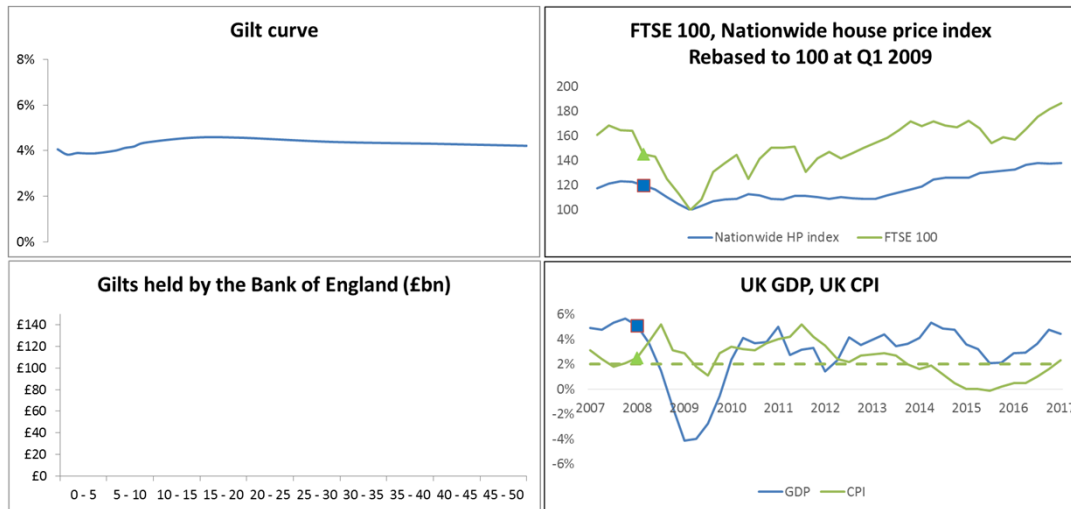


What does QE look like?

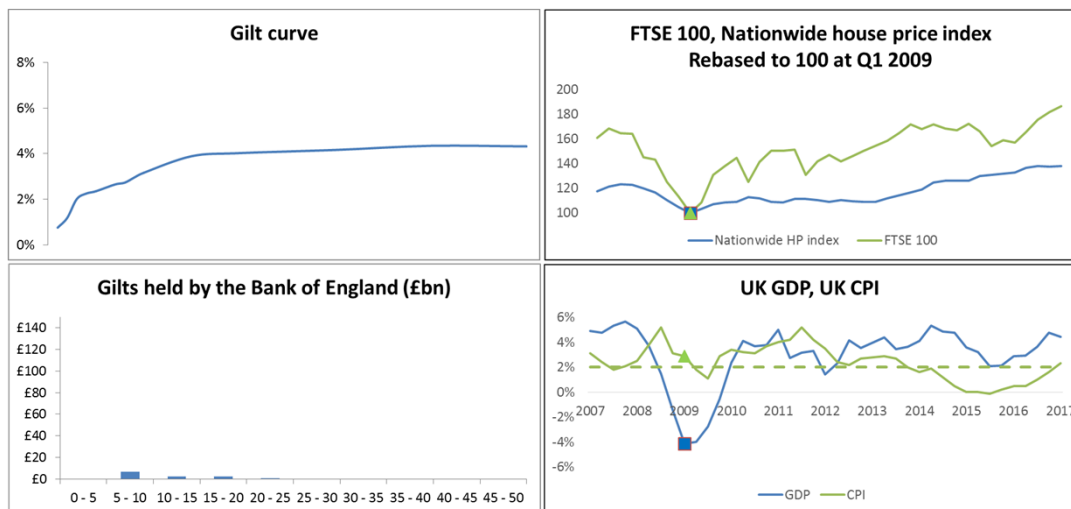
- What's happening to....
 - The gilt curve
 - The amount of bonds purchased
 - Asset prices
 - GDP
 - Inflation



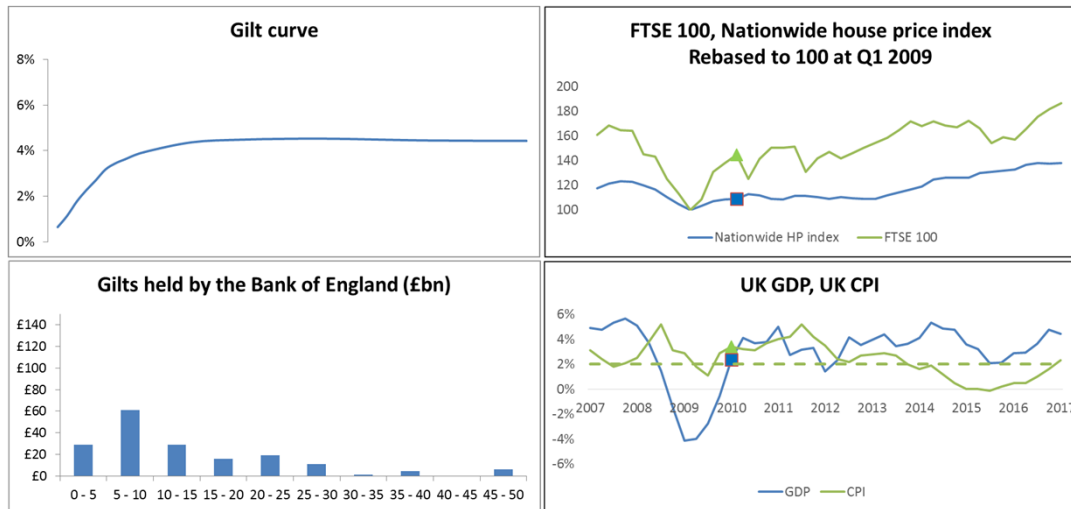
Q1 2007



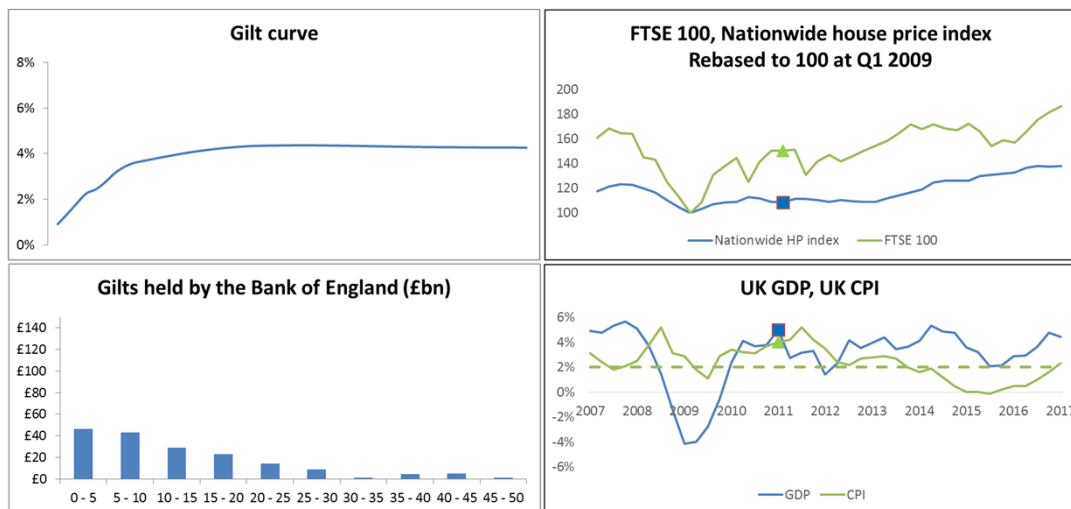
Q1 2008



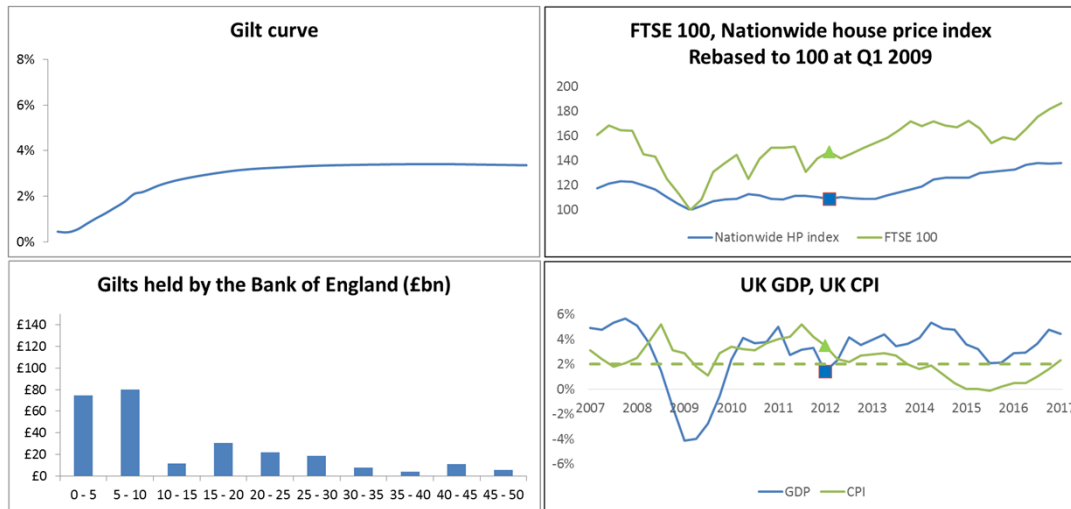
Q1 2009



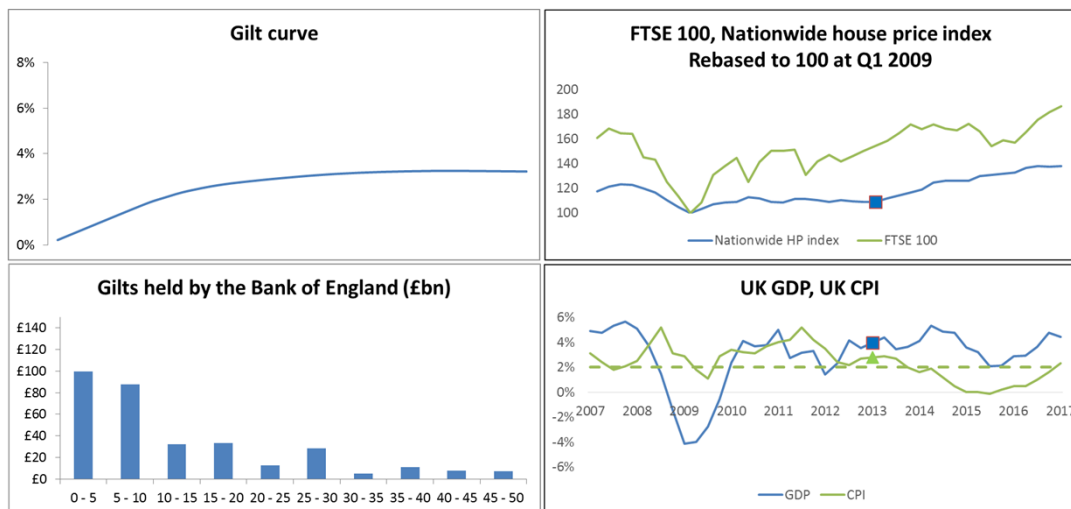
Q1 2010



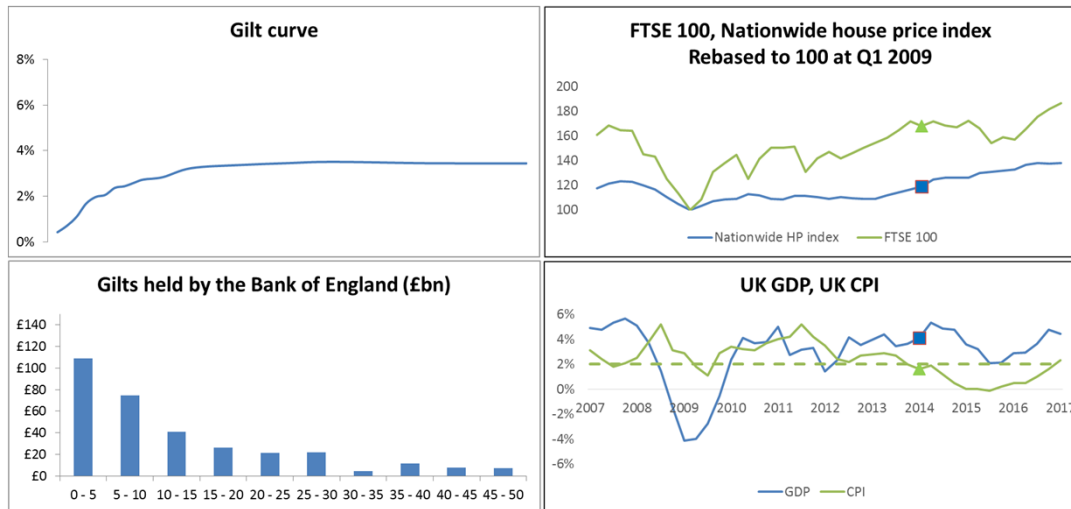
Q1 2011



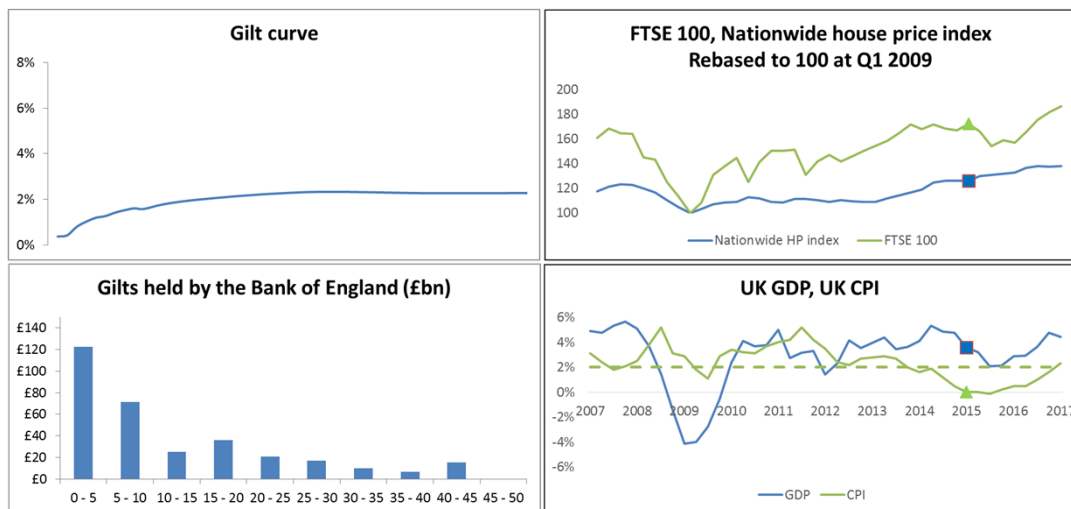
Q1 2012



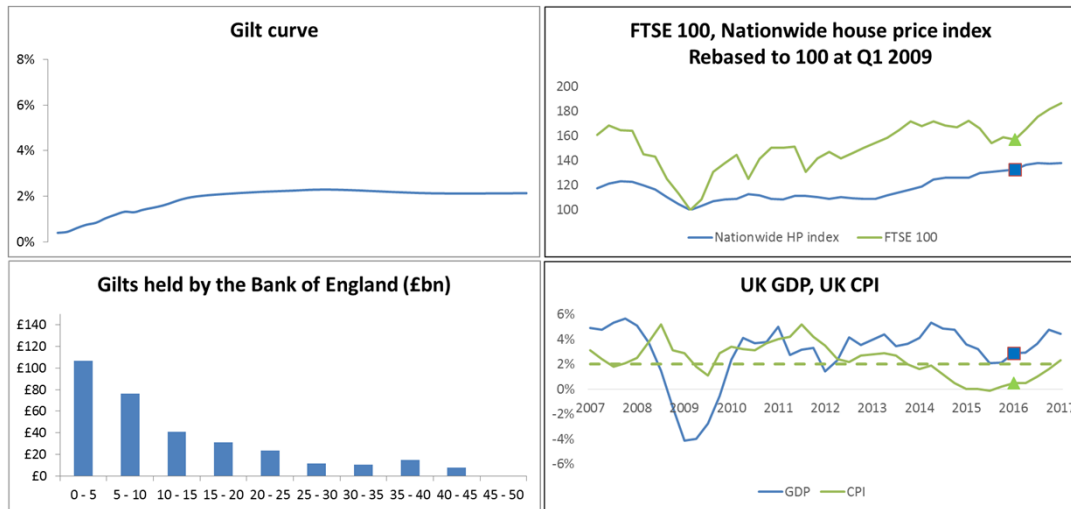
Q1 2013



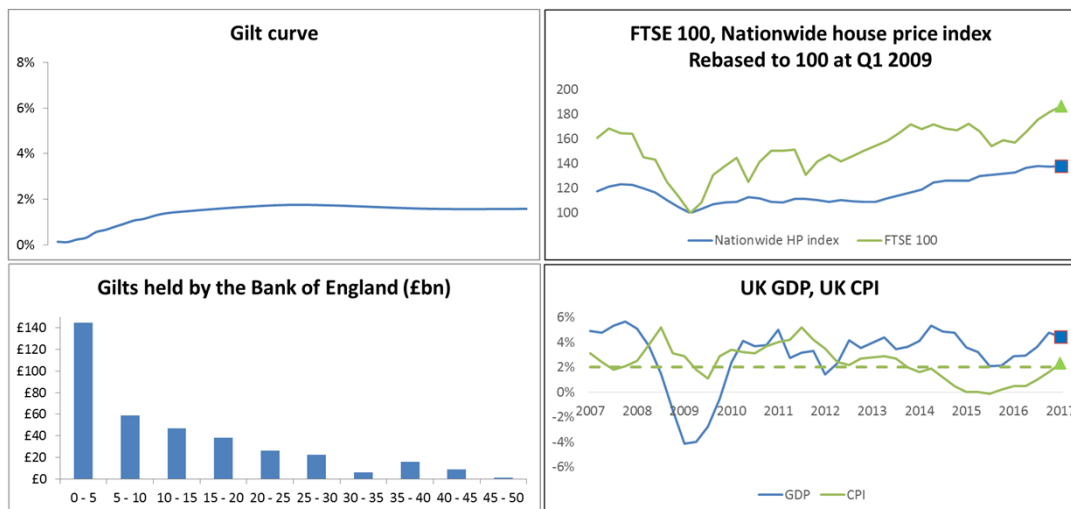
Q1 2014



Q1 2015



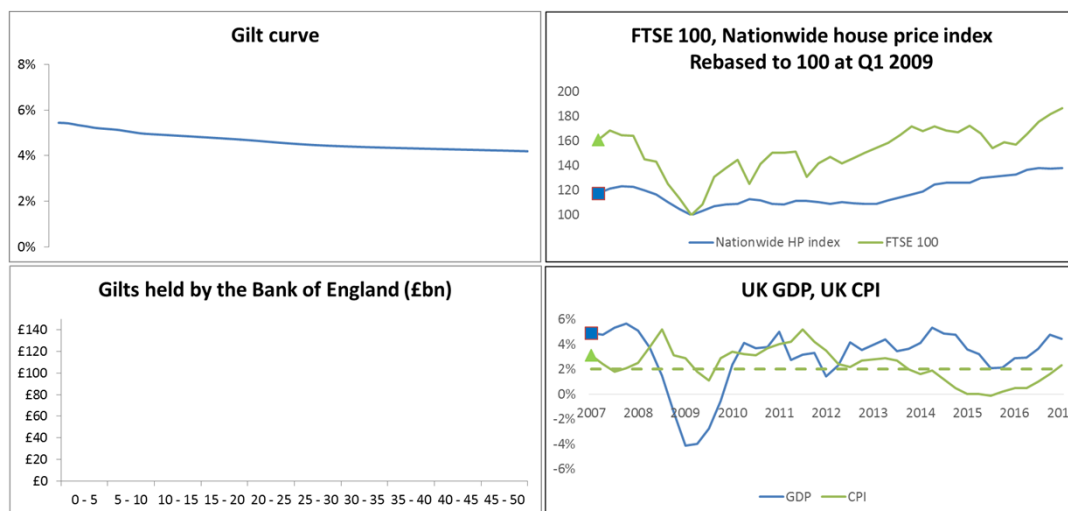
Q1 2016



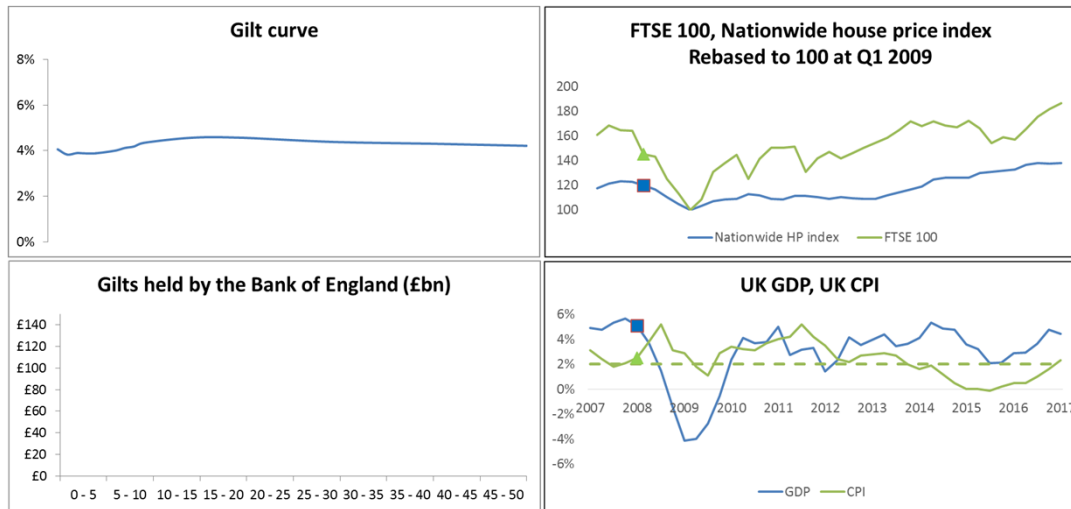
Q1 2017

Q1 2009 – Q1 2017

30-year spot rate	4.2% -> 1.7%
FTSE 100	+ 87%
Nationwide Housing Index	+ 38%
Real GDP	3.5%
Average CPI	2.2%



Q1 2007

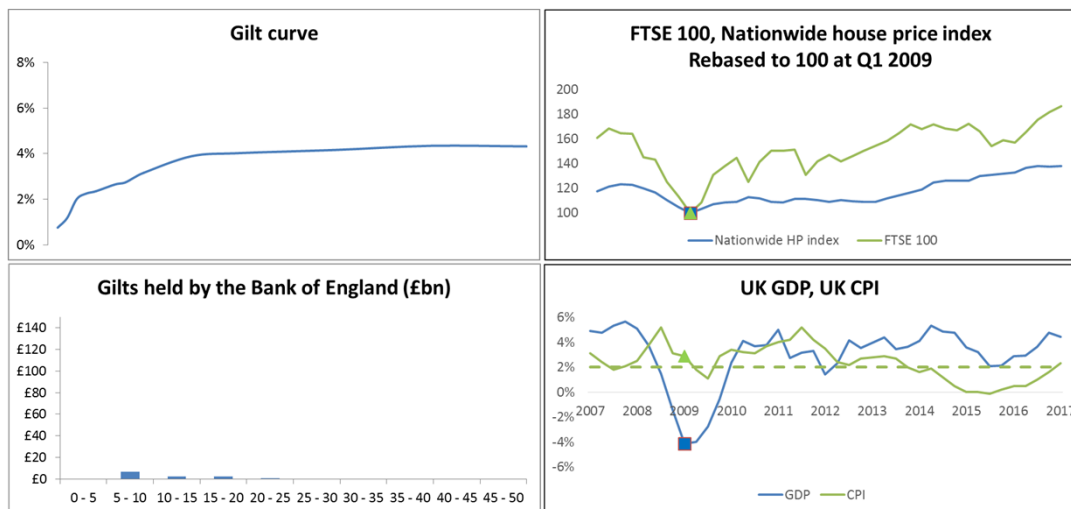


Q1 2008

Deloitte.  Institute and Faculty of Actuaries

09 June 2017

47

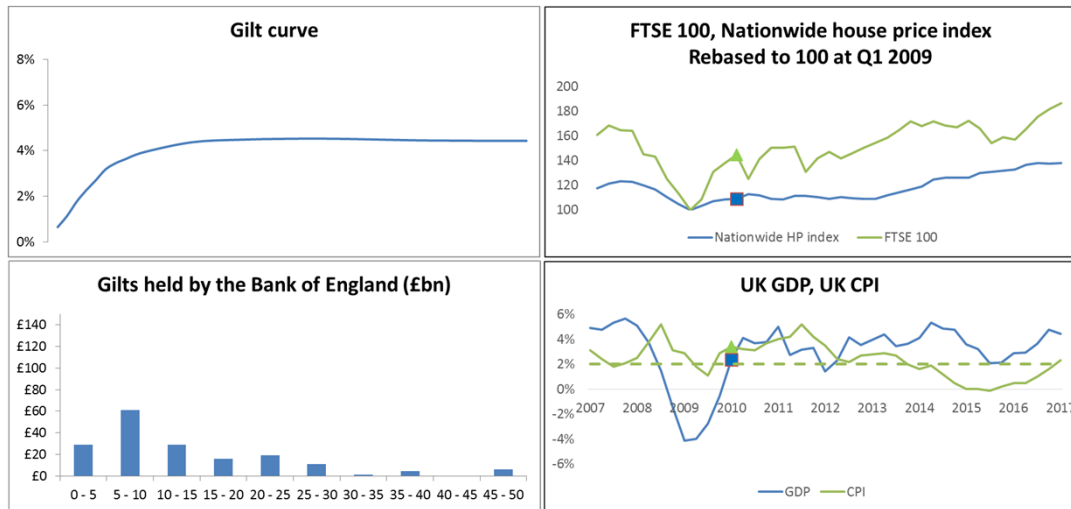


Q1 2009

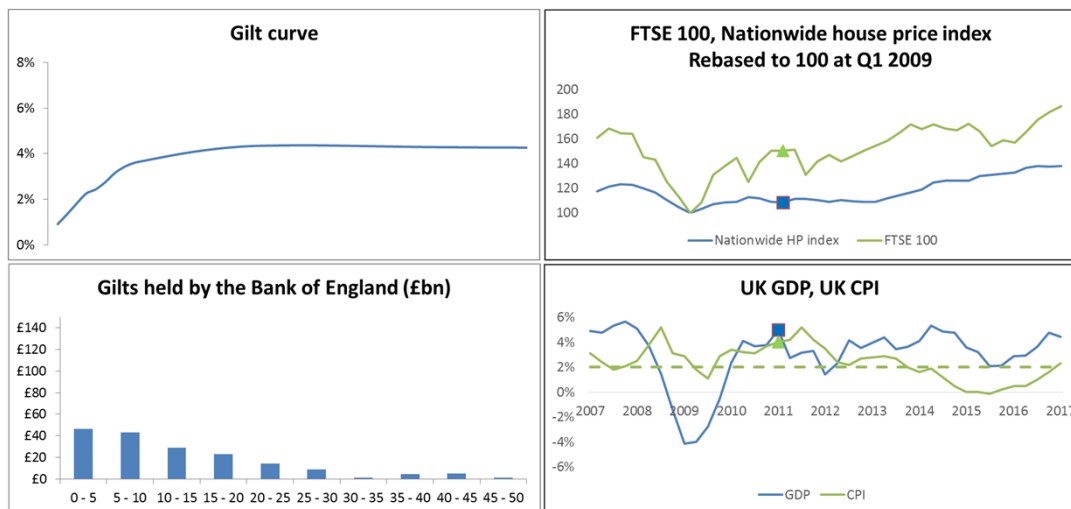
Deloitte.  Institute and Faculty of Actuaries

09 June 2017

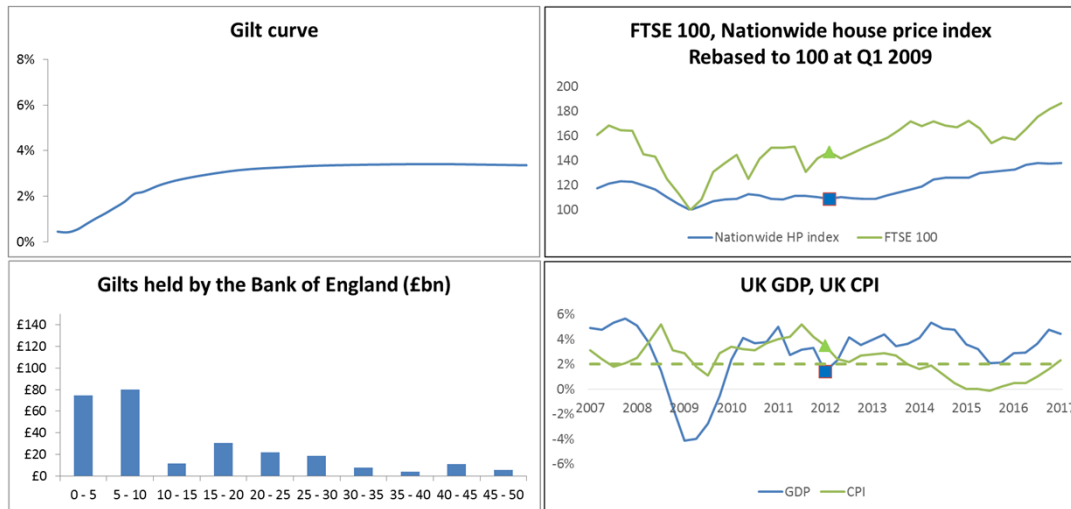
48



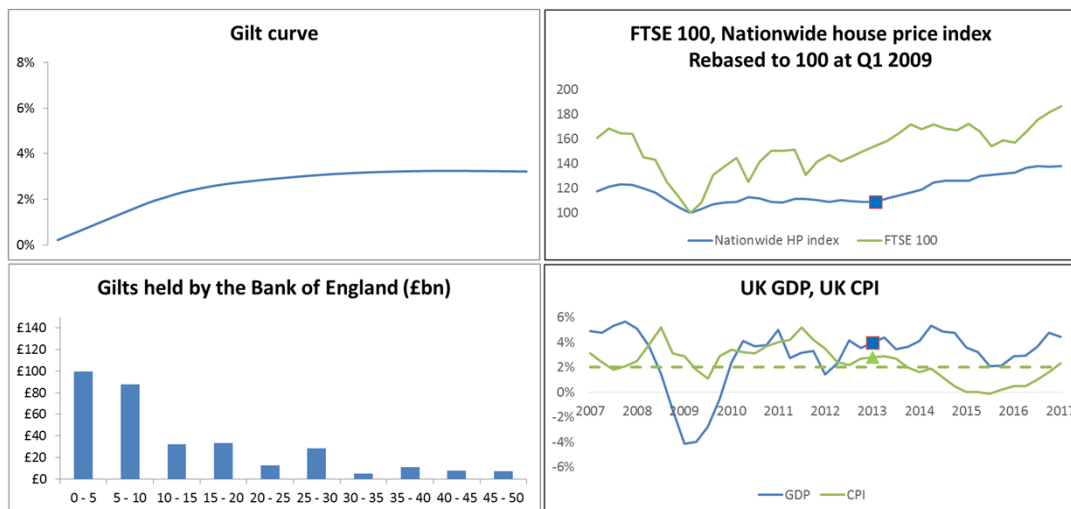
Q1 2010



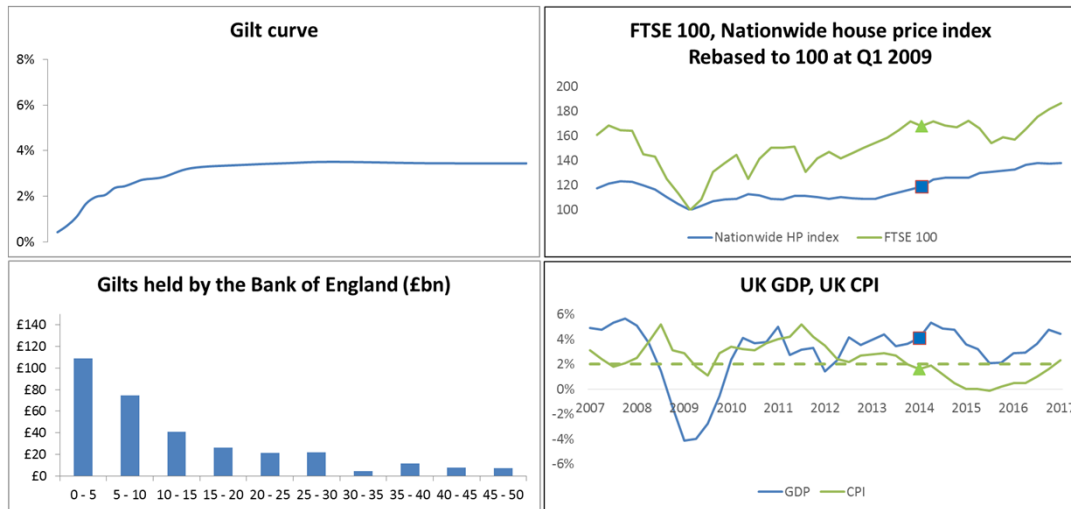
Q1 2011



Q1 2012



Q1 2013

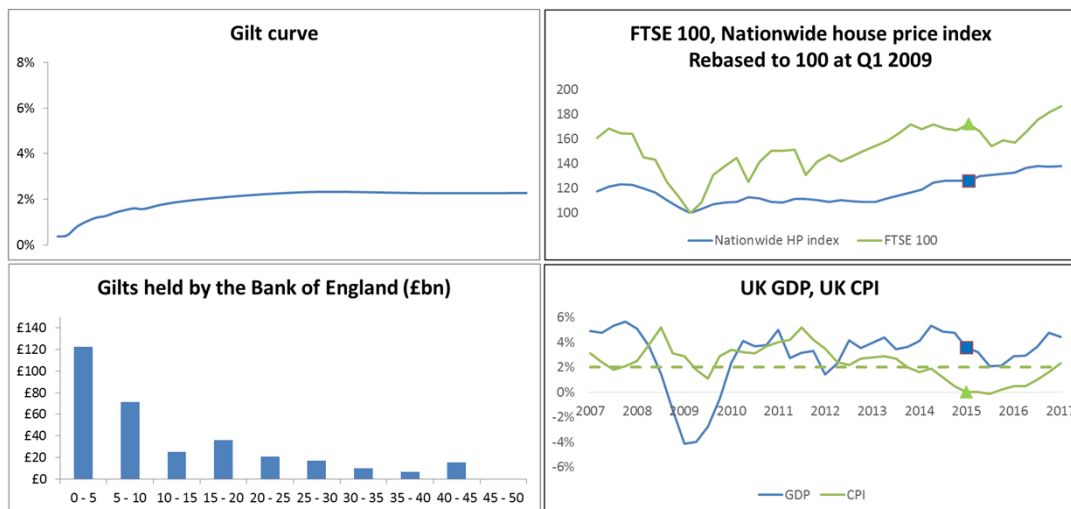


Q1 2014

Deloitte.  Institute and Faculty of Actuaries

09 June 2017

53

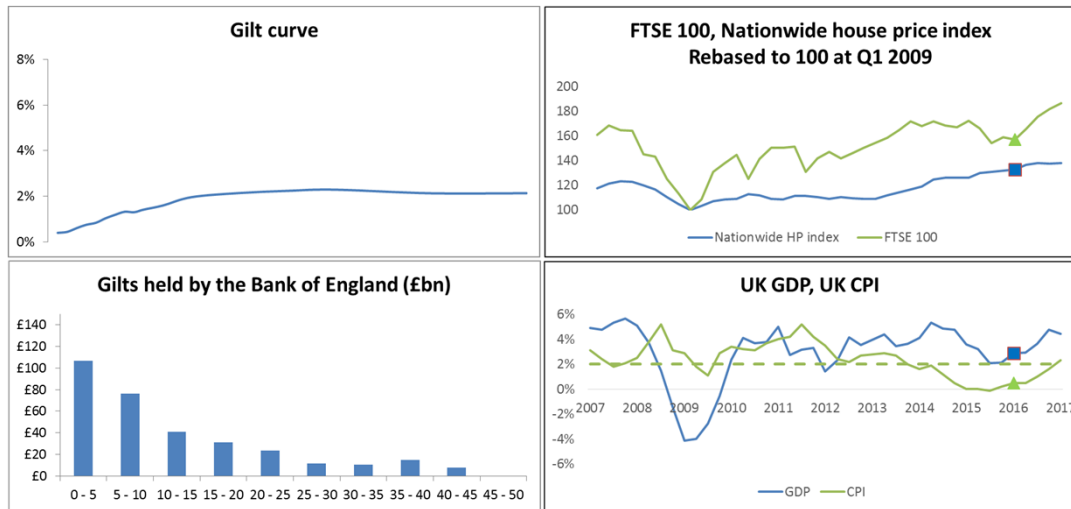


Q1 2015

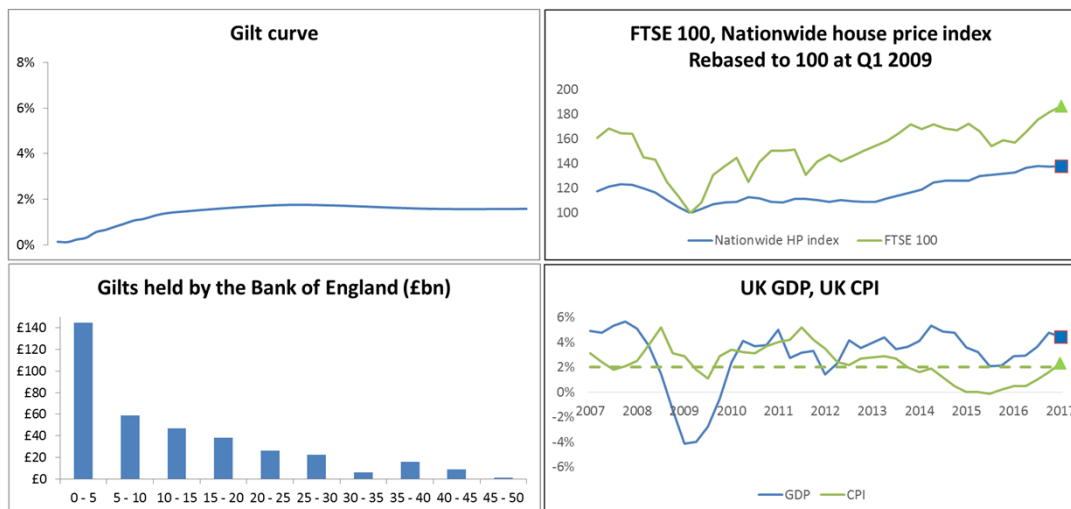
Deloitte.  Institute and Faculty of Actuaries

09 June 2017

54



Q1 2016



Q1 2017

QE did what it promised

It should ultimately lead to an increase in asset prices and spending and therefore bring inflation back to target

QE did what it promised

It should ultimately lead to an increase in asset prices and spending and therefore bring inflation back to target

But what else did it bring us?

What else did QE bring us?

- Debt

09 June 2017

59

What else did QE bring us?

- Debt
- Dependency

09 June 2017

60

What else did QE bring us?

- Debt
- Dependency
- Market distortion

09 June 2017

61

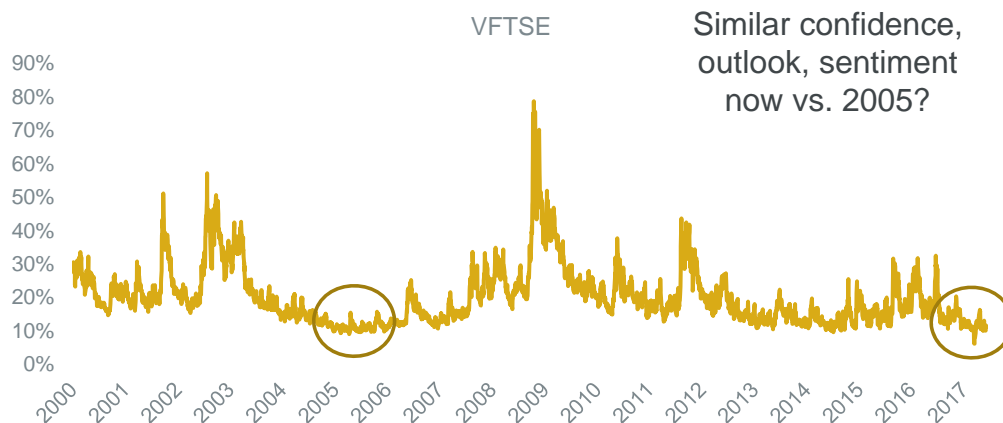
The (extreme) search for yield

- In 2016 Austria sold 2bn Euros of 70-year debt at 1.5%
- Consider the risks:
 - Long term, very high duration
 - Will the Euro exist in 70 years' time?
- For context, for SII, EIOPA deem the last liquid point for the Euro to be 20 years

09 June 2017

62

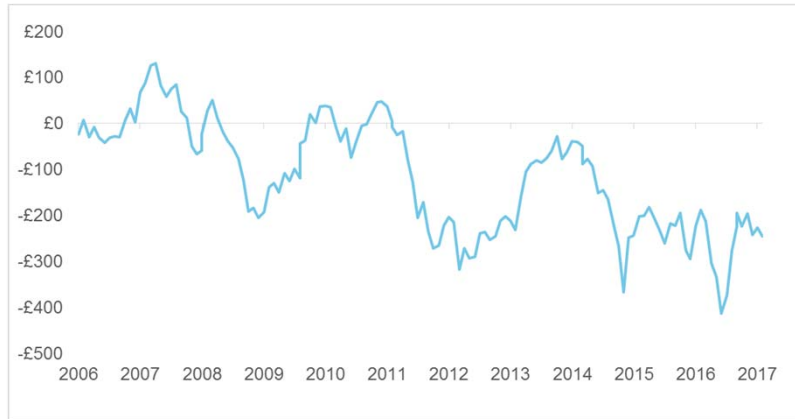
Yet the market is (implied) calm



What else did QE bring us?

- Debt
- Dependency
- Market distortion
- Pension deficits

PPF estimate of aggregate DB deficits (£bn)



Deloitte.



Institute
and Faculty
of Actuaries

09 June 2017

65

PPF estimate of aggregate DB deficits (£bn) + 20Y gilt spot rate



Deloitte.



Institute
and Faculty
of Actuaries

09 June 2017

66

What else did QE bring us?

- Debt
- Dependency
- Market distortion
- Pension deficits
- A new predicament

09 June 2017

67

What else did QE bring us?

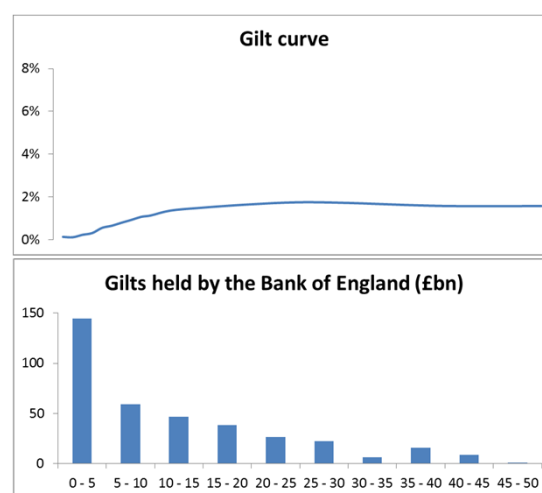
- Debt
- Dependency
- Market distortion
- Pension deficits
- A new predicament
 - Central bank cannot walk away
 - Nor can it stay there forever
 - How does it extract itself?

09 June 2017

68

How will QE unwind?

Q1 2017



The options

- Sell bonds, reduce balance sheet
- Let bonds mature, with no repurchase
- Repurchase such that maturity and/or notional reduce over time
- Rollover indefinitely i.e. no unwind

09 June 2017

71

The options

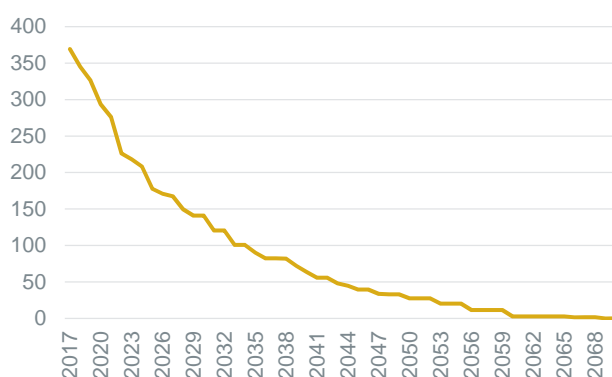
- Sell bonds, reduce balance sheet
- Let bonds mature, with no repurchase
- Repurchase such that maturity and/or notional reduce over time
- Rollover indefinitely i.e. no unwind

- +.....when should rates rise?

09 June 2017

72

Balance of gilts if QE left to run off (£bn)



What the Bank of England has said

- Q1 2009

The MPC will decide on the most appropriate way to withdraw the policy stimulus based on the circumstances prevailing at the time

What the Bank of England has said

- Q1 2014

*We're not going to sell £375 billion of gilts.
That's a hypothetical question, purely hypothetical*

Mark Carney to the Treasury Select Committee

What the Bank of England has said

- Q2 2014

The MPC's preference is to use Bank Rate as the active marginal instrument for monetary policy

What the Bank of England has said

- Q4 2015

The MPC expects to maintain the stock of purchased assets at £375 billion until Bank Rate has reached a level from which it can be cut materially

09 June 2017

77

Is there another way?

09 June 2017

78

Is there another way?

Question	Answer
Does the current mandate make sense?	
Is monetary policy a suitable tool?	
What did QE bring us?	
How will QE unwind?	

Is there another way?

Question	Answer
Does the current mandate make sense?	In broad terms yes Necessary but not sufficient
Is monetary policy a suitable tool?	
What did QE bring us?	
How will QE unwind?	

Is there another way?

Question	Answer
Does the current mandate make sense?	In broad terms yes Necessary but not sufficient
Is monetary policy a suitable tool?	To lower inflation, yes To raise inflation, it's a blunt tool
What did QE bring us?	
How will QE unwind?	

Is there another way?

Question	Answer
Does the current mandate make sense?	In broad terms yes Necessary but not sufficient
Is monetary policy a suitable tool?	To lower inflation, yes To raise inflation, it's a blunt tool
What did QE bring us?	Exactly what it promised. And more... Debt, dependency, distortion, new risks
How will QE unwind?	

Is there another way?

Question	Answer
Does the current mandate make sense?	In broad terms yes Necessary but not sufficient
Is monetary policy a suitable tool?	To lower inflation, yes To raise inflation, it's a blunt tool
What did QE bring us?	Exactly what it promised. And more... Debt, dependency, distortion, new risks
How will QE unwind?	Rates then QE (maybe)

The issues that central banks need to address

- Short-termism

The issues that central banks need to address

- Short-termism
- Denial that monetary policy has limitations and costs

09 June 2017

85

The issues that central banks need to address

- Short-termism
- Denial that monetary policy has limitations and costs
- Application of outdated economics

09 June 2017

86

What needs to be change?

- Genuine oversight and accountability

09 June 2017

87

What needs to be change?

- Genuine oversight and accountability
- Better alignment of fiscal and monetary policy

09 June 2017

88

What needs to be change?

- Genuine oversight and accountability
- Better alignment of fiscal and monetary policy
- Wider mandate

What needs to be change?

- Genuine oversight and accountability
- Better alignment of fiscal and monetary policy
- Wider mandate
- Start to unwind QE – intention is key

Long term thinking is vital

Colin Wilson

Questions

Comments

The views expressed in this [publication/presentation] are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this [publication/presentation] and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this [publication/presentation].

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this [publication/presentation] be reproduced without the written permission of the IFoA [or authors, in the case of non-IFoA research].