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# QE and the inflation dogma

## Does it work and does it make sense?

Richard Silveira PhD



# Agenda

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



# Does the current mandate make sense?



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# Does the current mandate make sense?

- Why does the BoE exist?

*To promote the good of the people of the United Kingdom*



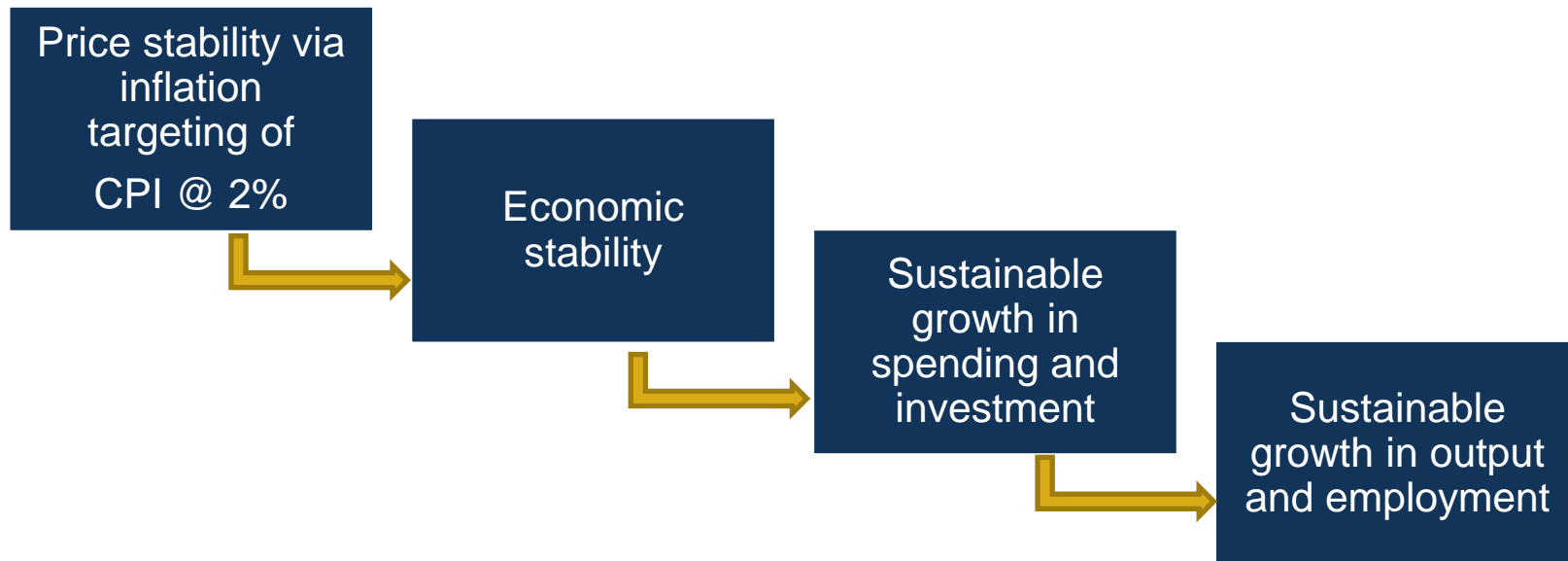
# Does the current mandate make sense?

- 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



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# Is a single metric sensible?



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

So what else matters?

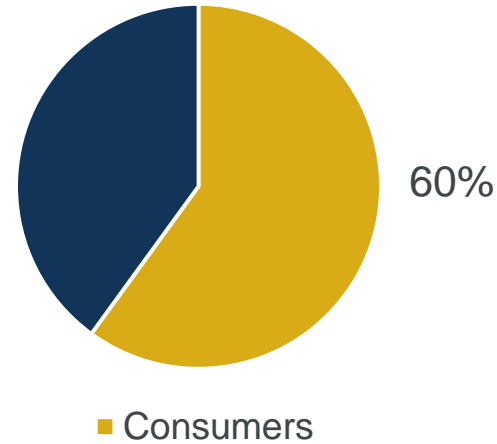


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# Is a single metric sensible?



GDP is driven by consumers



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# Is a single metric sensible?



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

So what else matters  
for consumers?



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# Is a single metric sensible?



Wage ***inflation?***

House price ***inflation?***

Rental ***inflation?***

Pension ***inflation?***



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# 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?



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# The central banker's toolbox

Setting base  
rates



Macro-prudential  
regulation

Quantitative  
Easing (QE)

Open market  
operations



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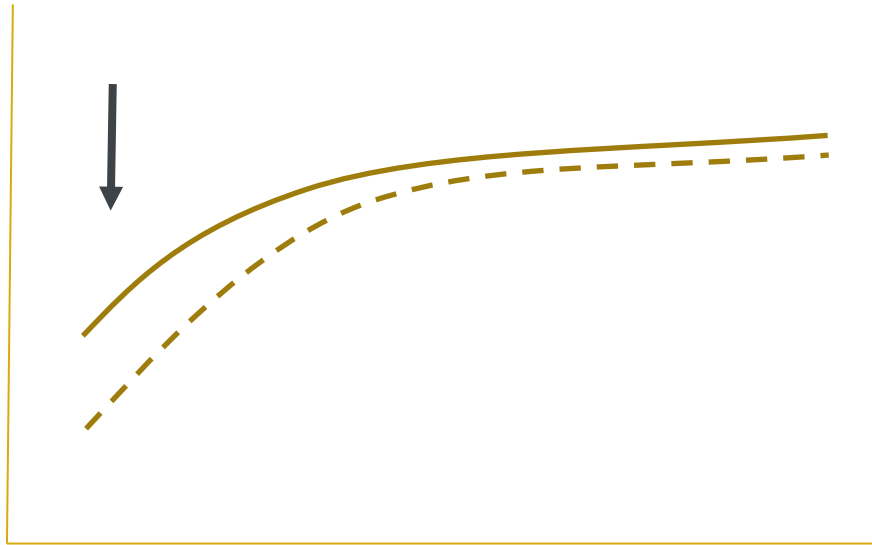


# The central banker's toolbox

- 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



# The central banker's toolbox



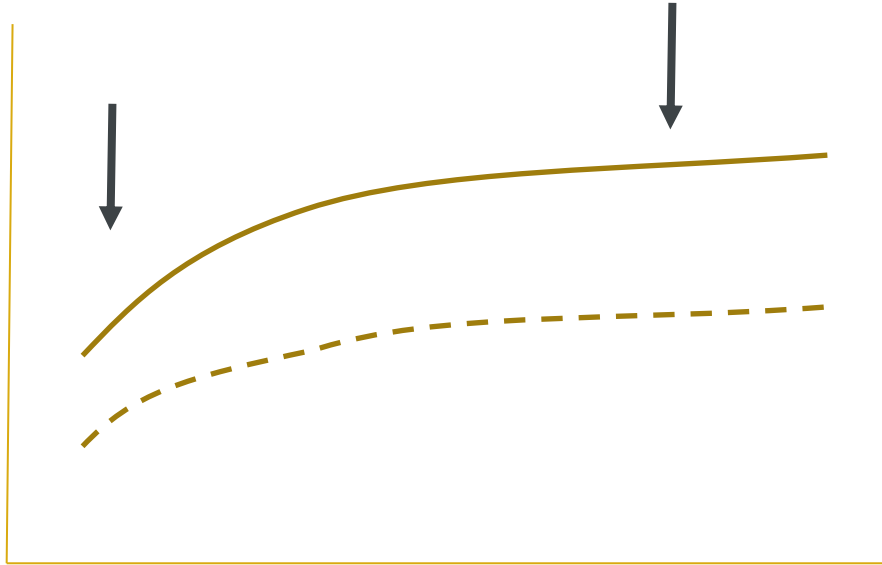
Set the base rate

Longer terms  
affected through  
expectation



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# The central banker's toolbox



Set the base rate

Longer terms  
affected through  
expectation

Add QE for direct  
influence



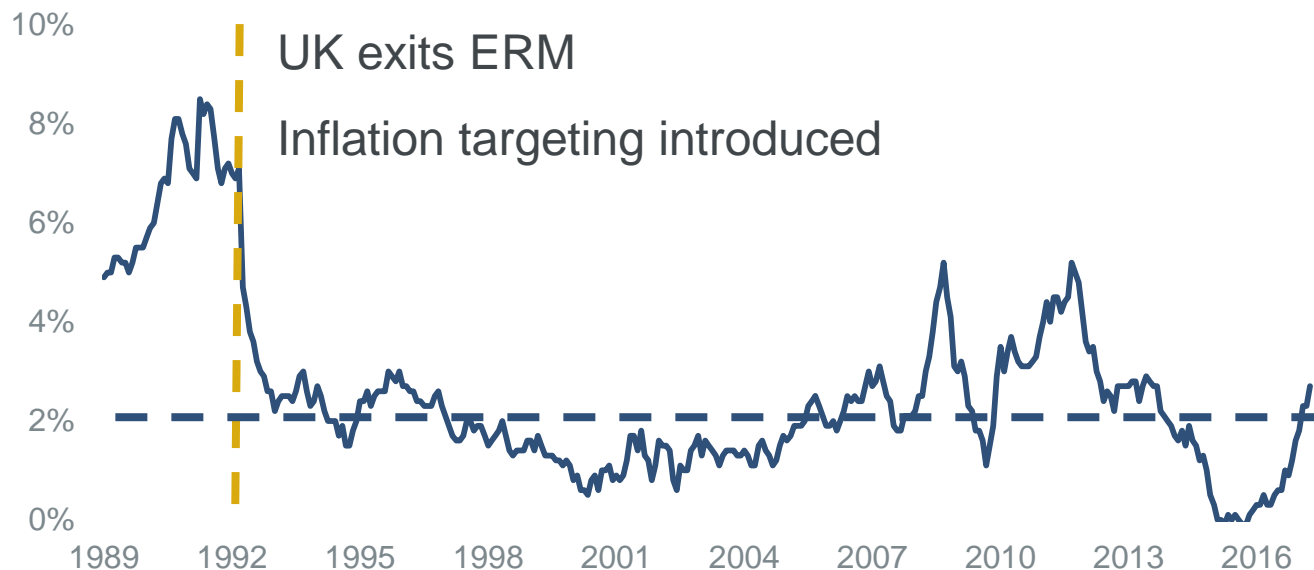
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# Is monetary policy a suitable tool to lower inflation?

- 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

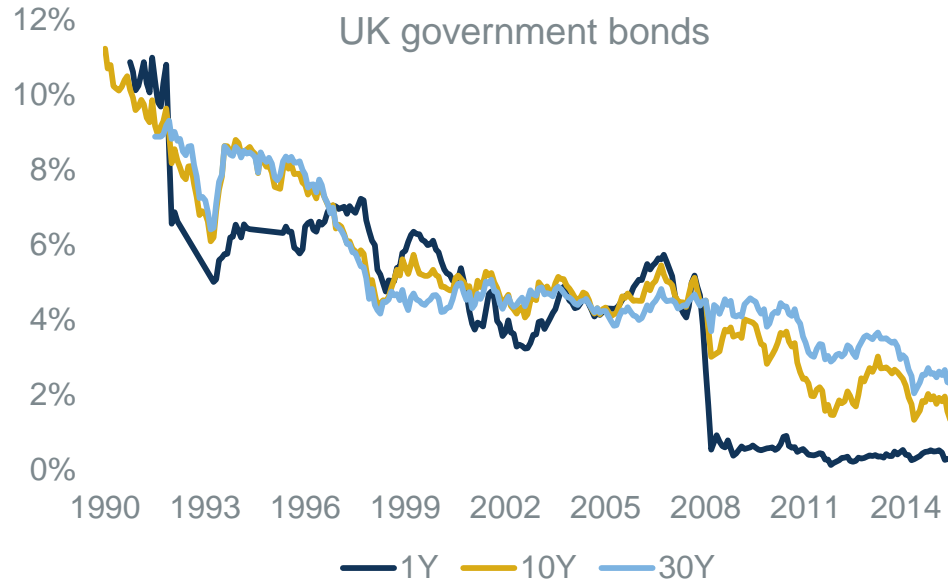


# Limitations of monetary policy

- 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?



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# What are the alternatives to monetary policy?

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



# What did QE bring us?



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## 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*



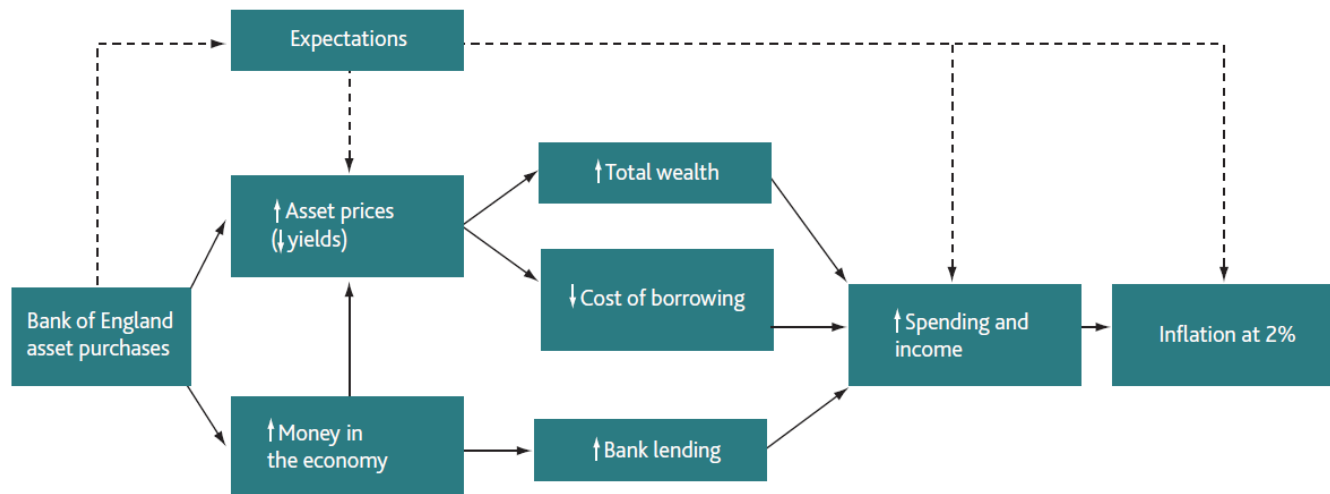
## Background – March 2009

*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*

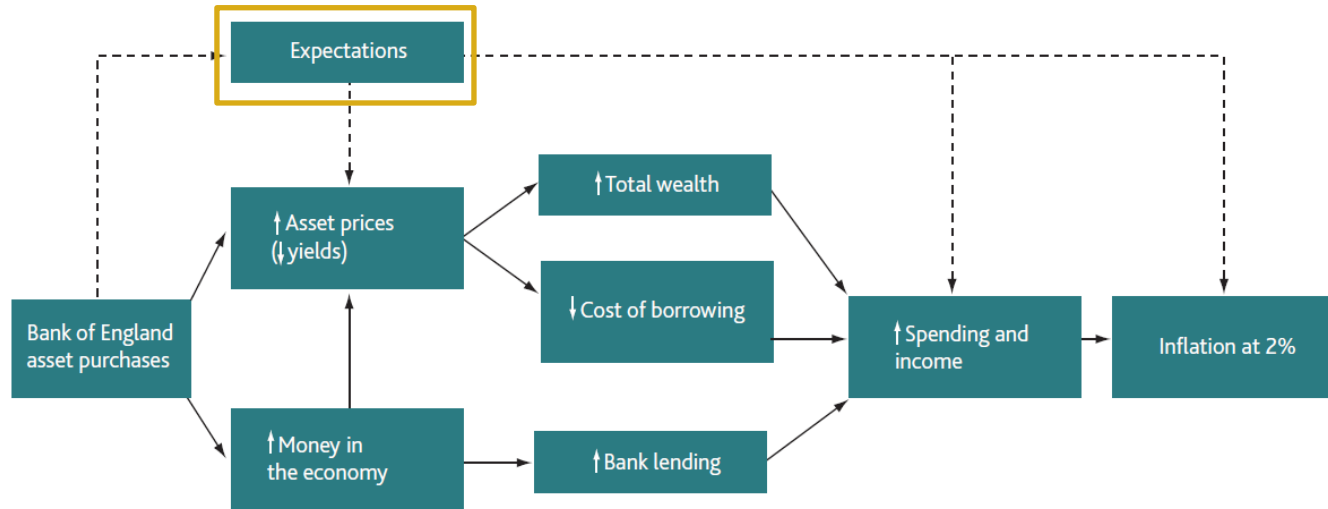


# Mechanism



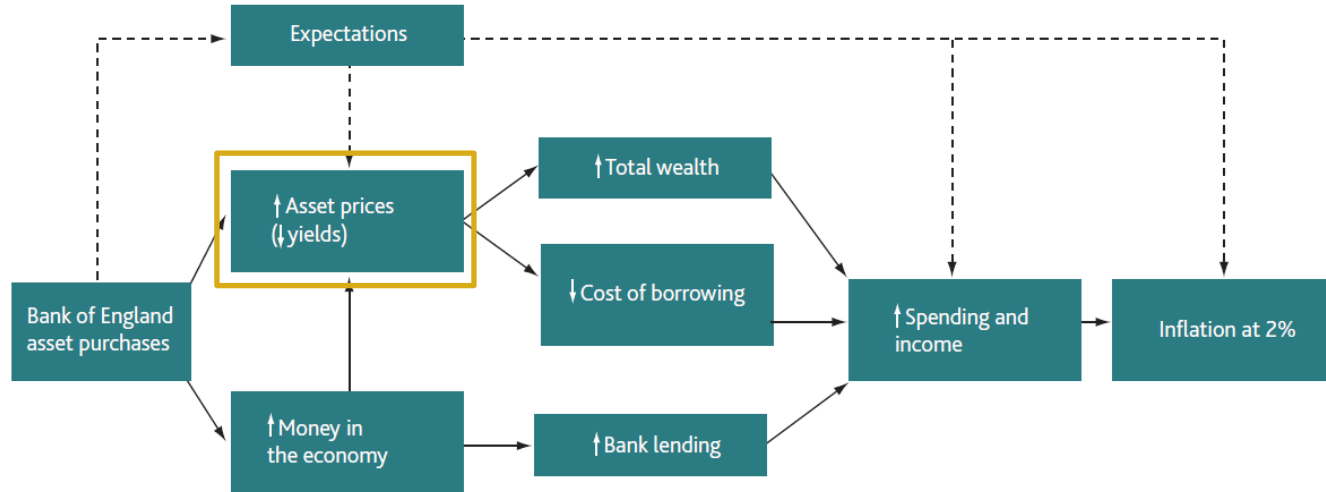
# Mechanism

*Asset purchases could have an important impact on expectations*



# Mechanism

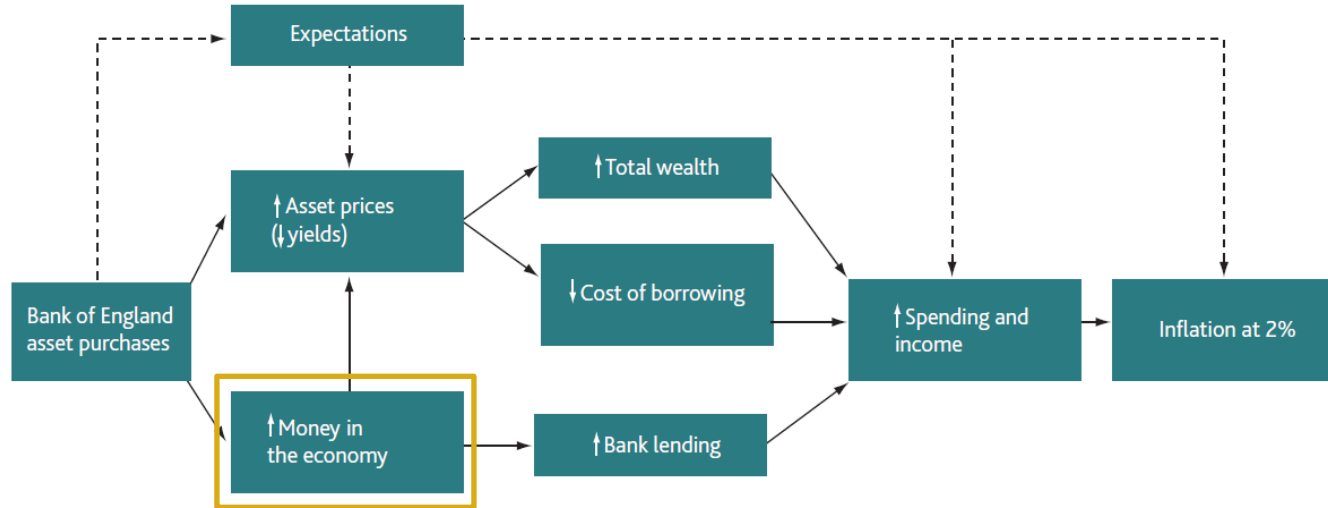
*...higher asset prices increase the wealth of asset holders, which should boost their spending*





# Mechanism

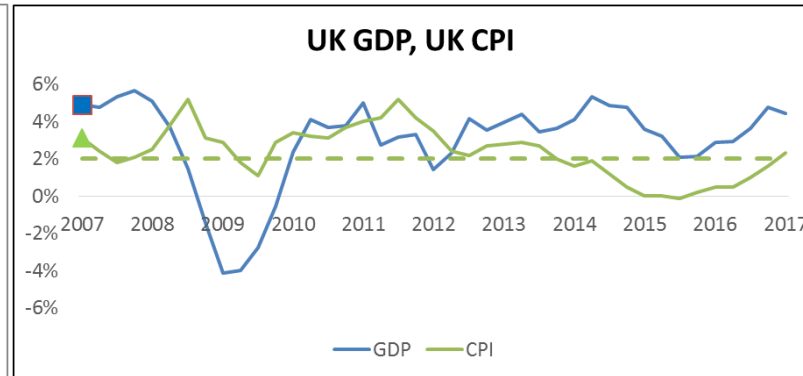
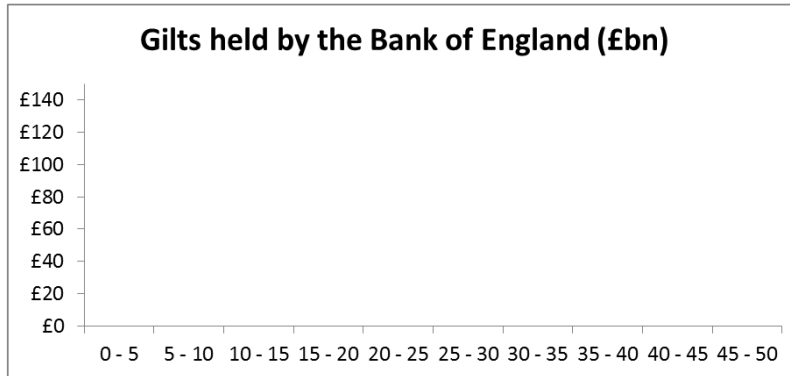
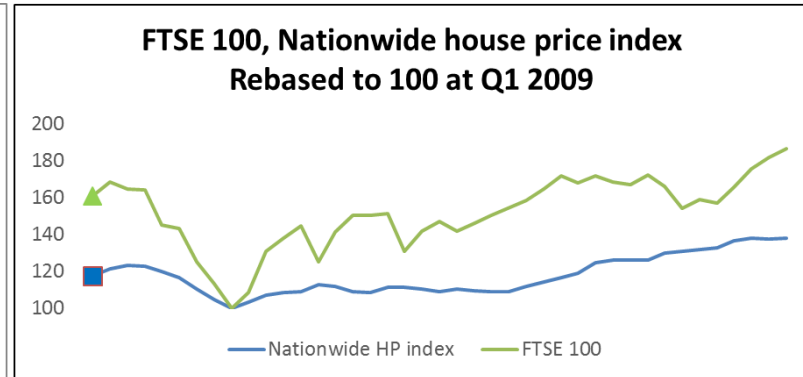
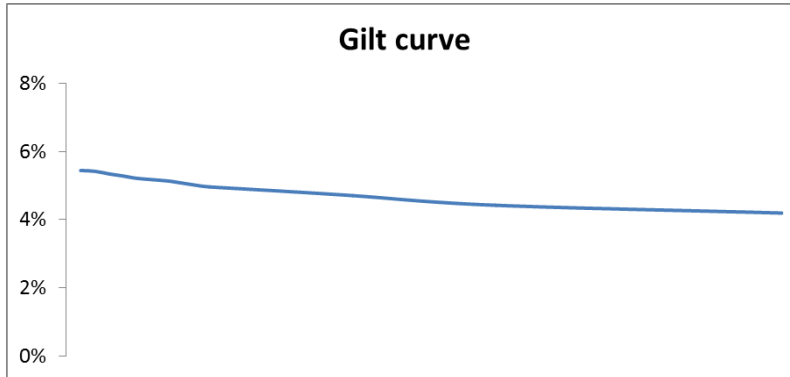
*More bank lending to households and companies should help to support higher consumption and investment*



# What does QE look like?

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

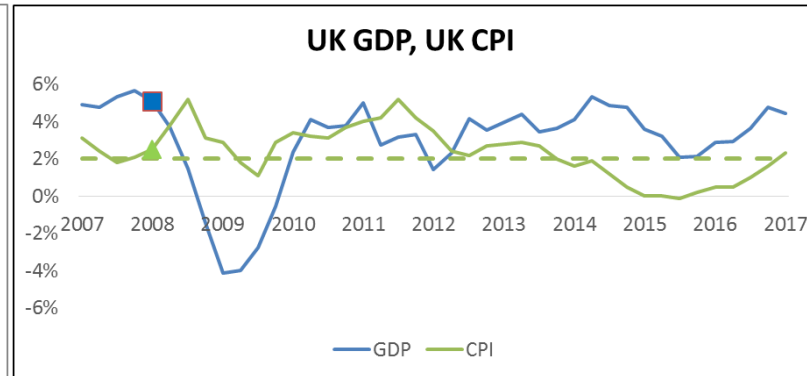
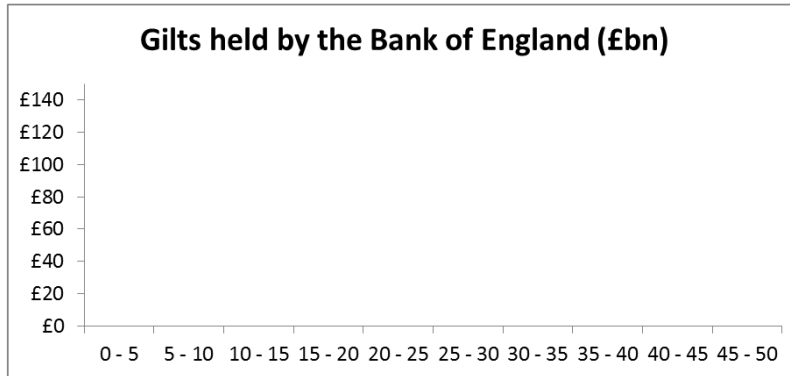
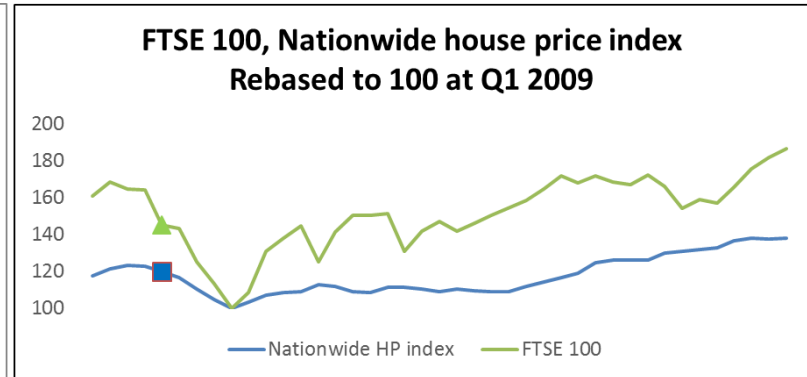
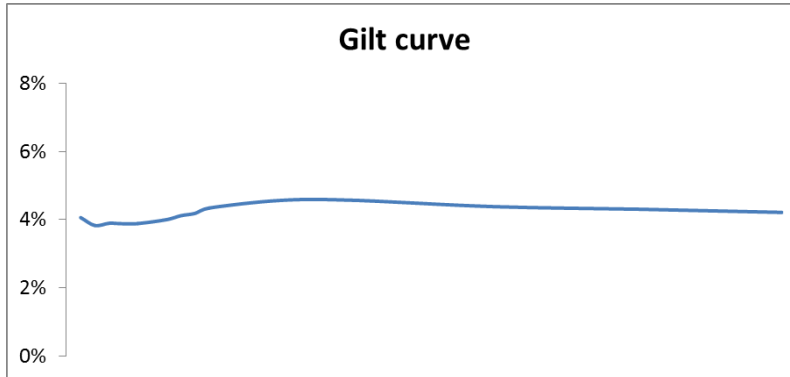




**Q1 2007**



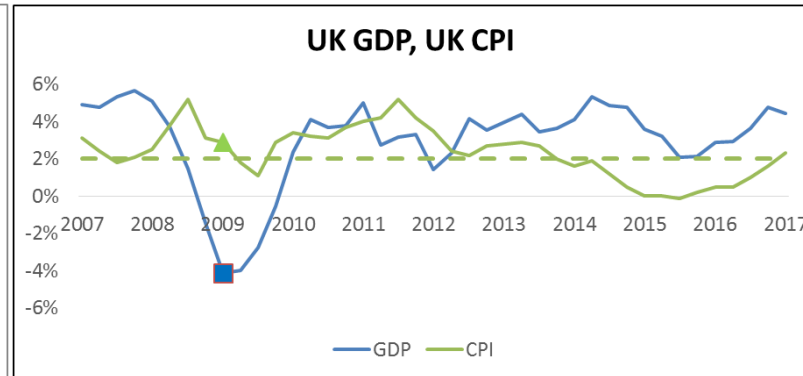
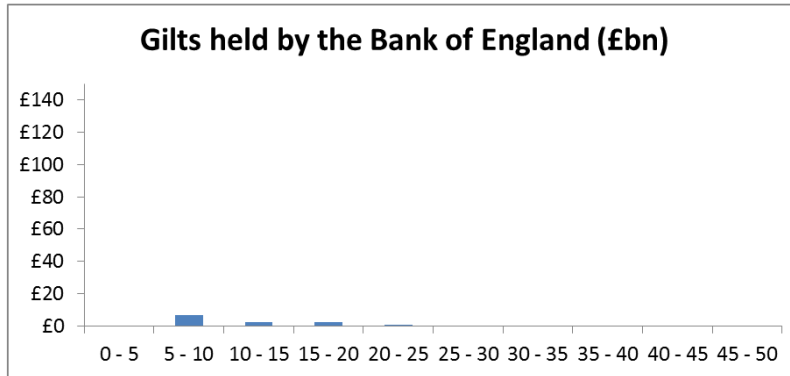
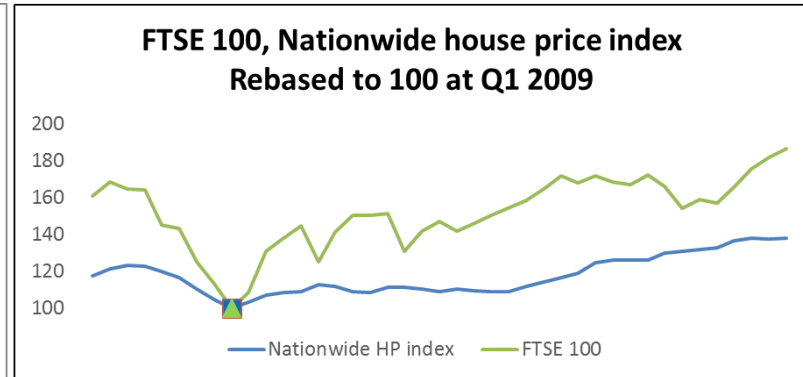
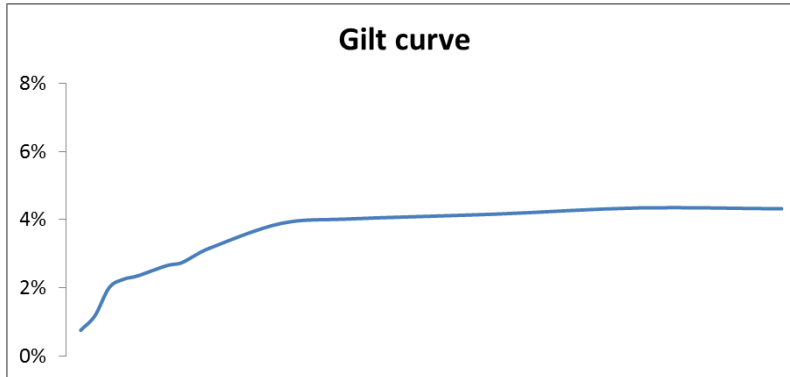
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# Q1 2008



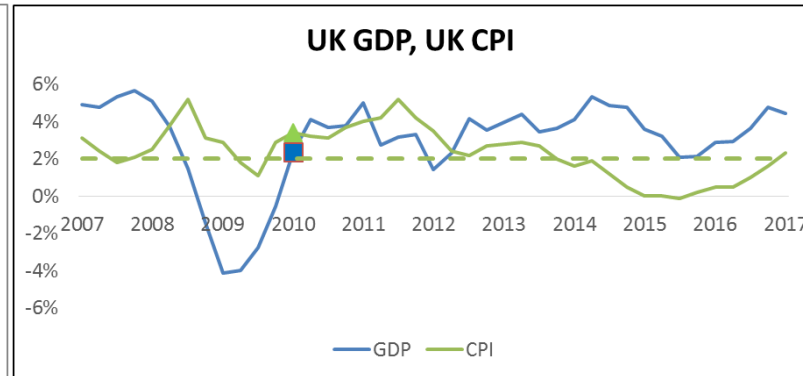
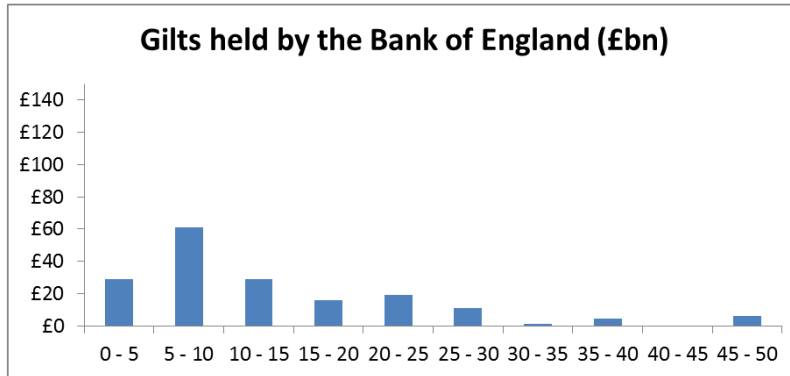
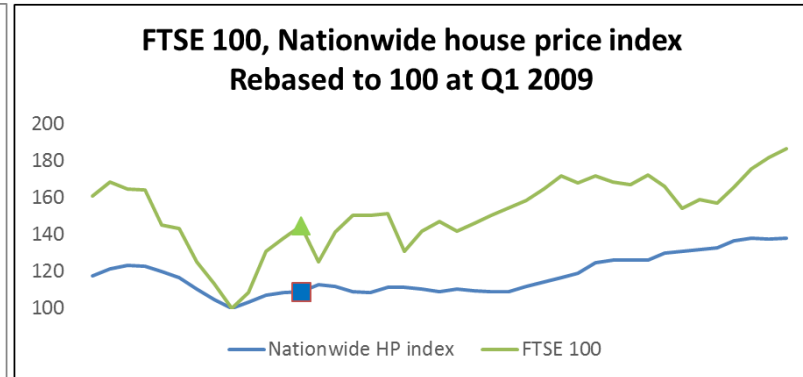
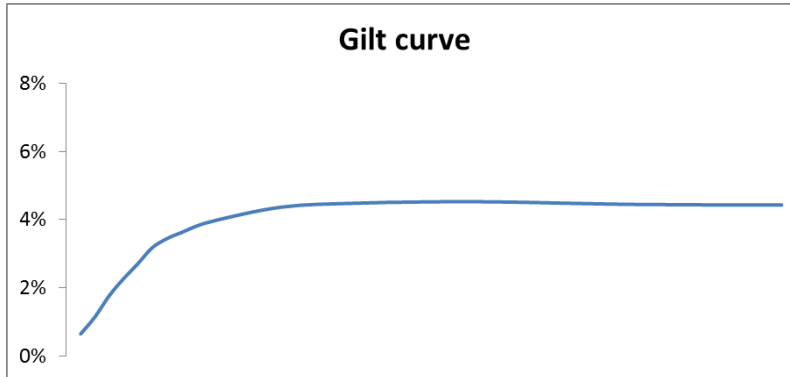
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# Q1 2009



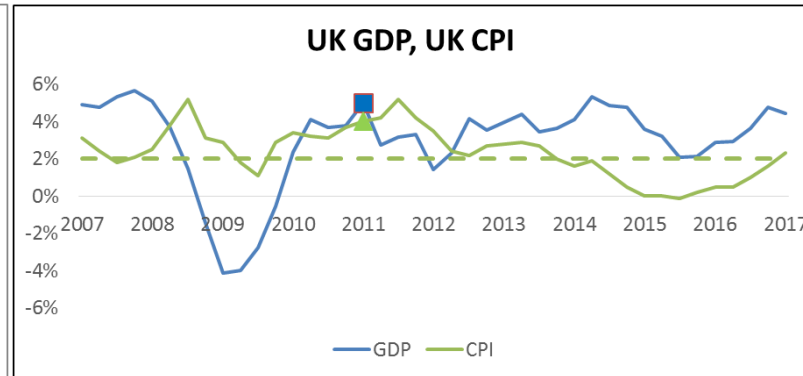
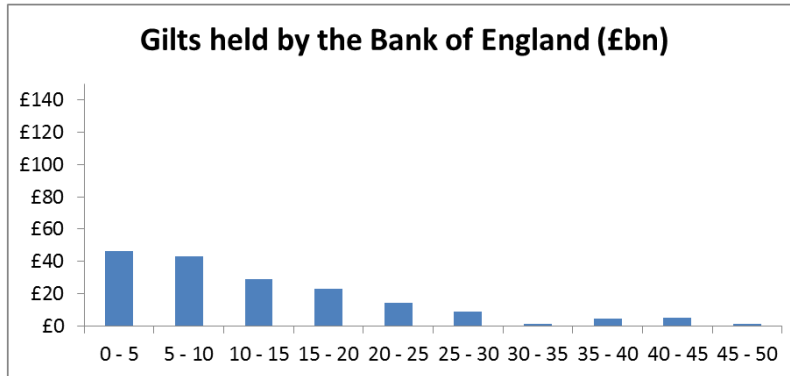
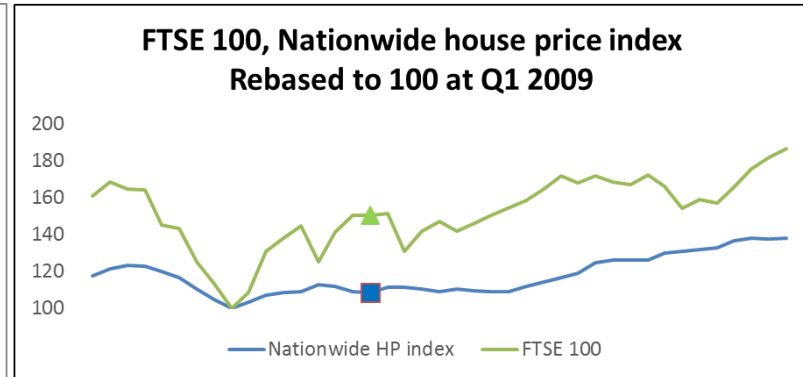
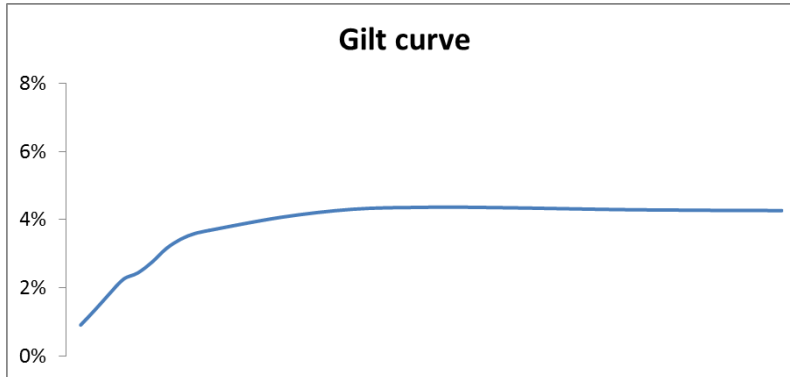
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# Q1 2010



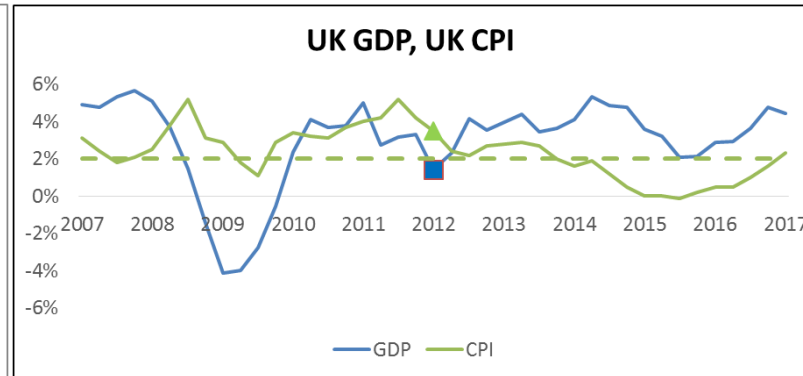
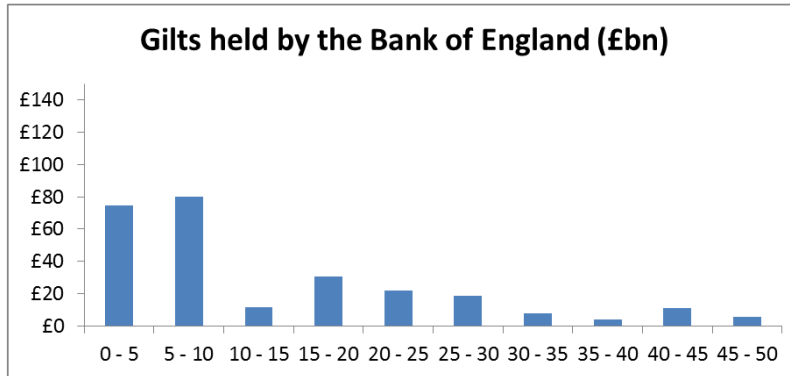
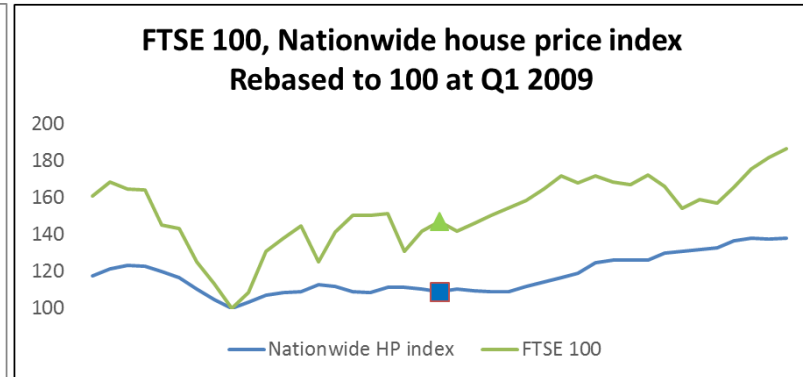
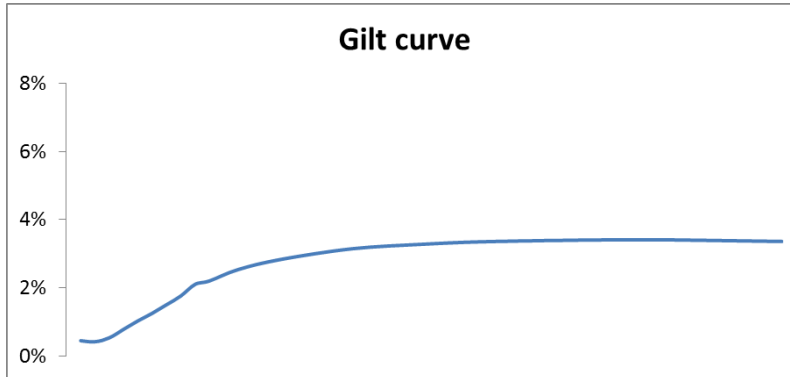
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# Q1 2011



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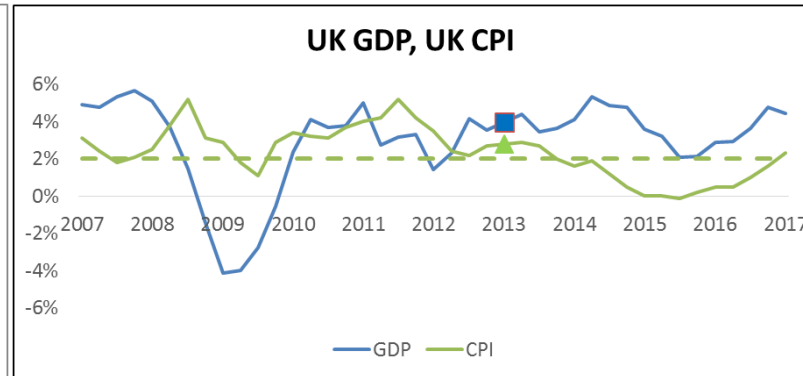
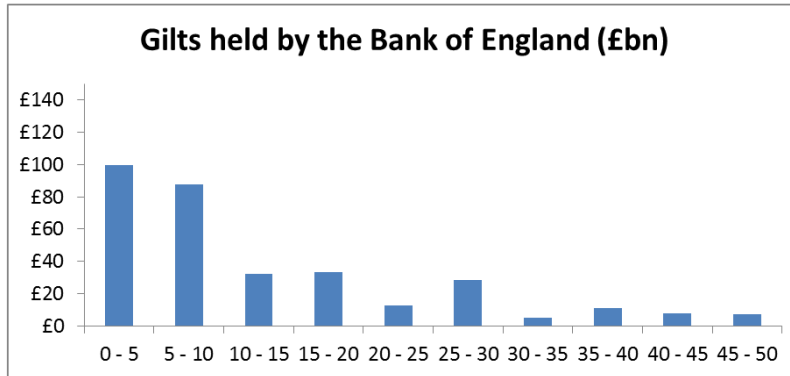
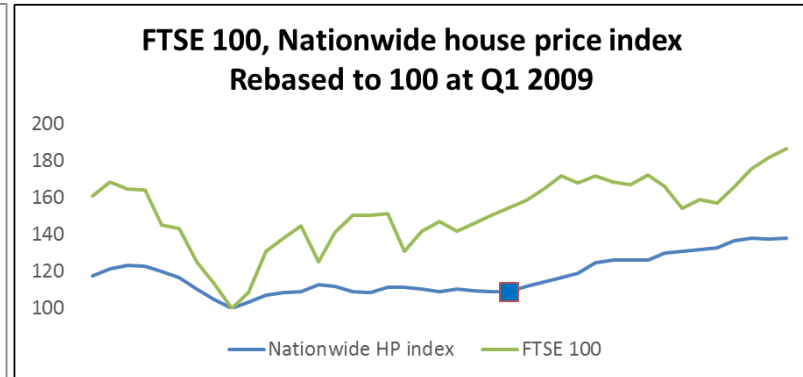
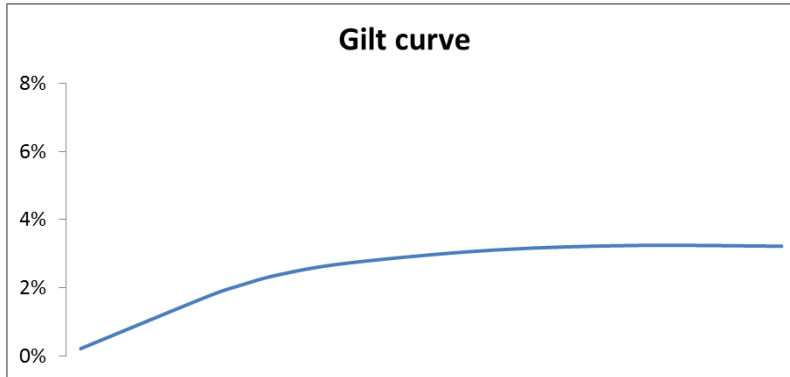


# Q1 2012



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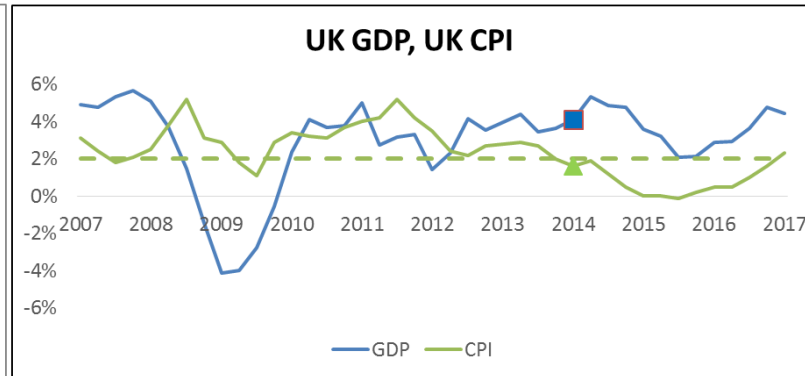
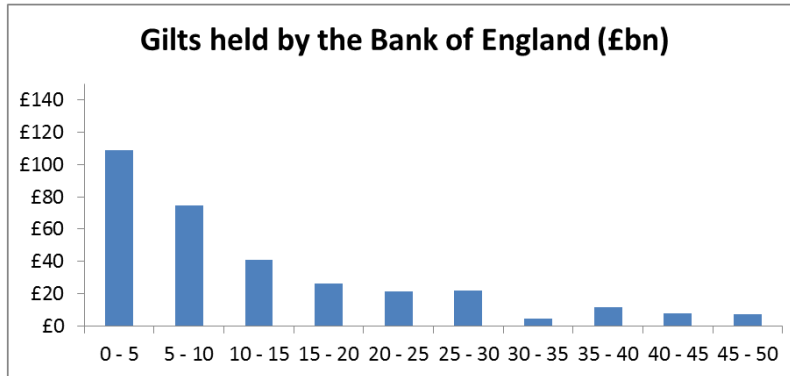
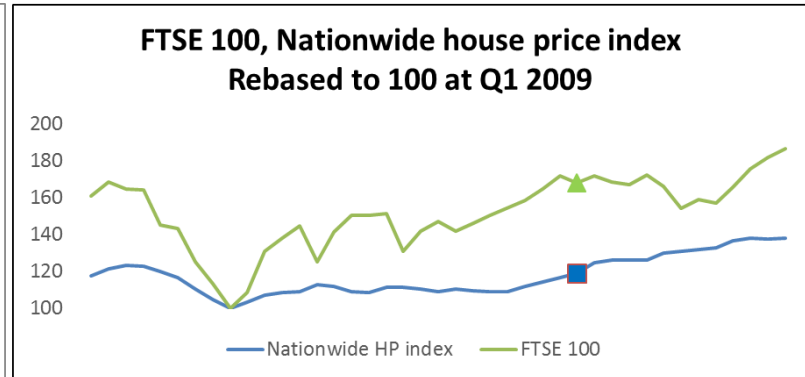
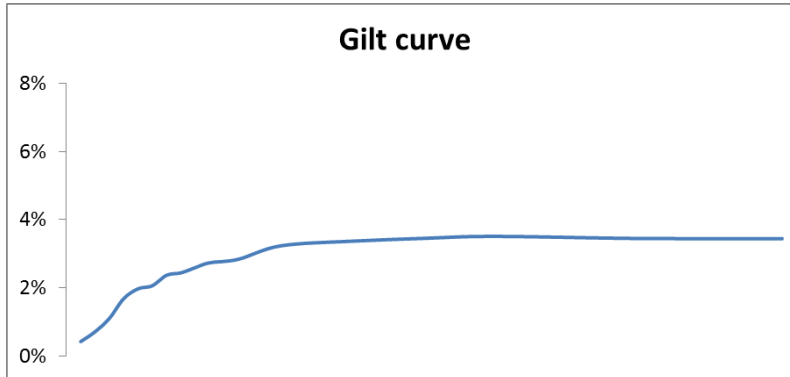




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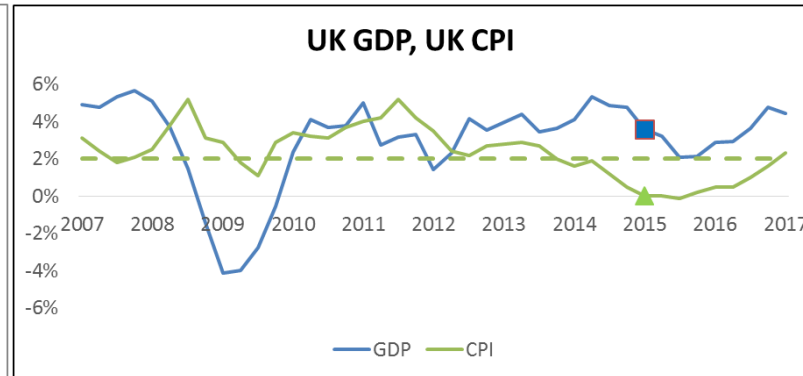
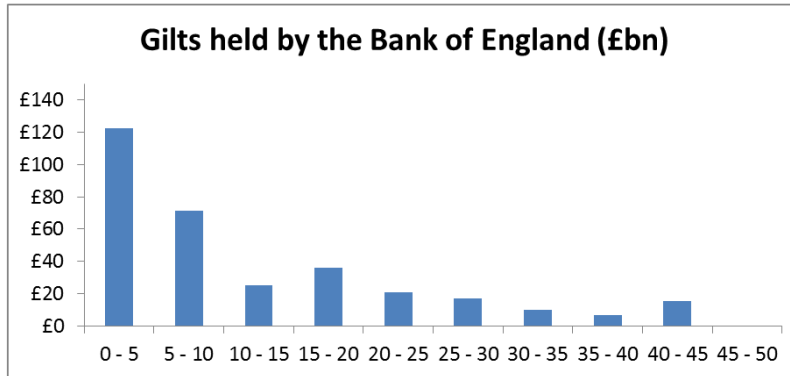
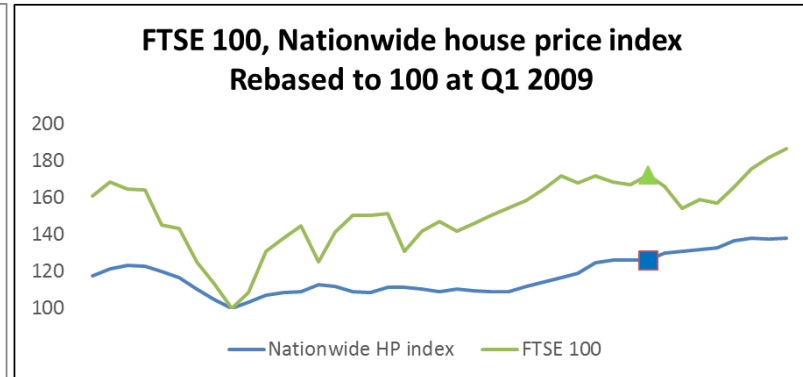
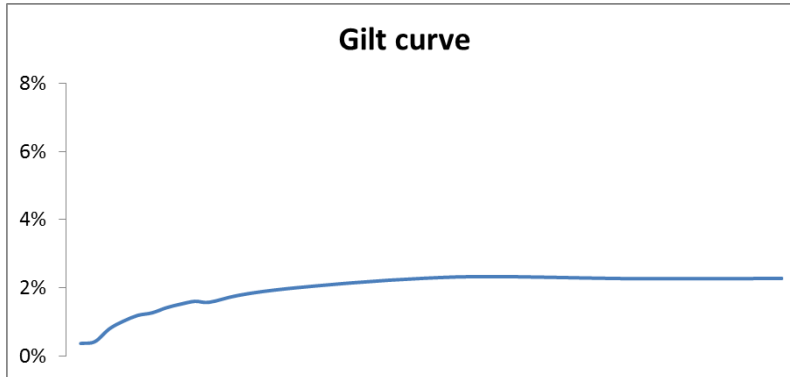
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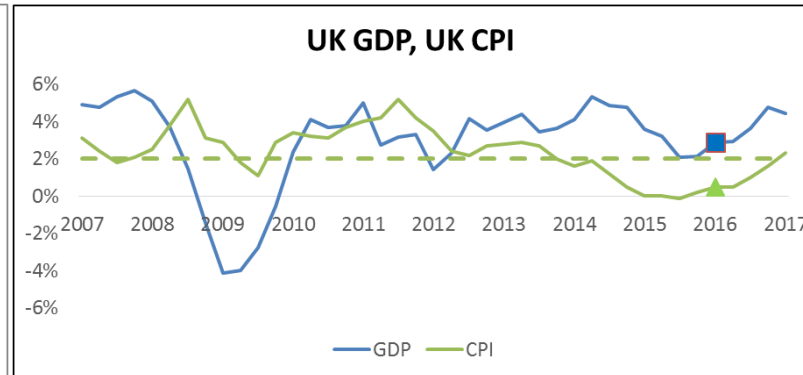
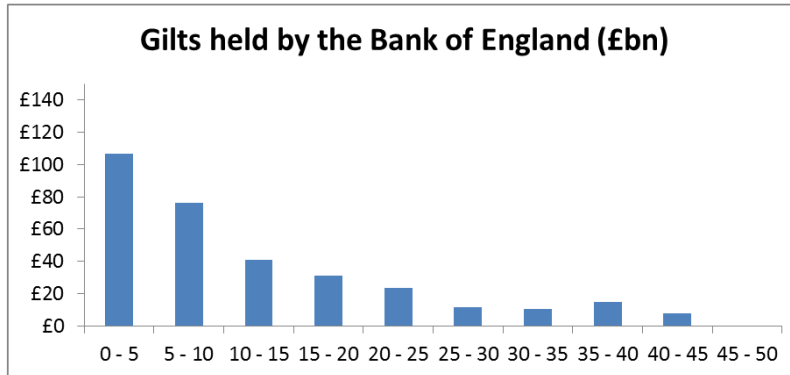
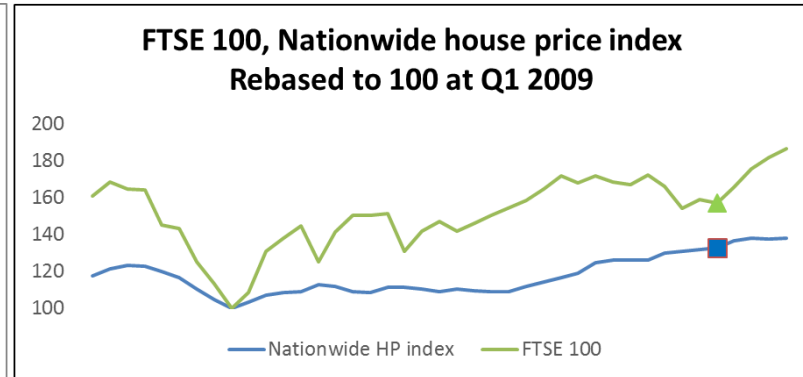
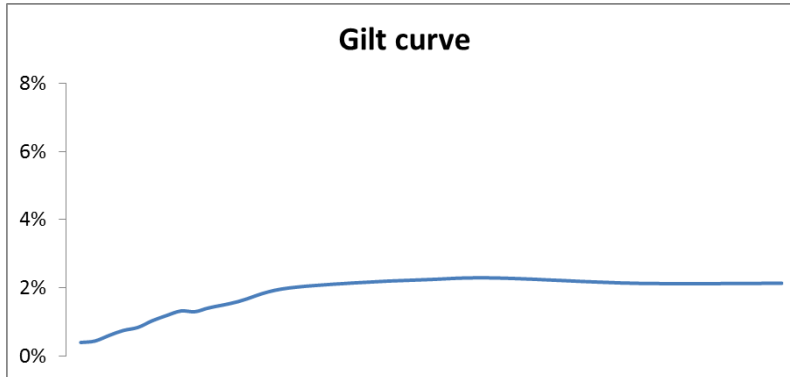
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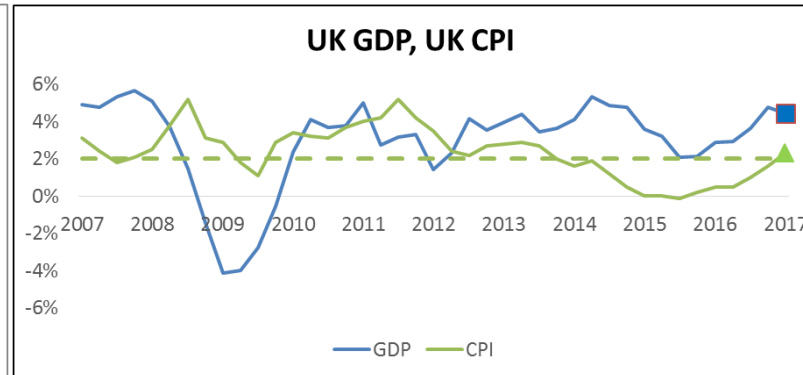
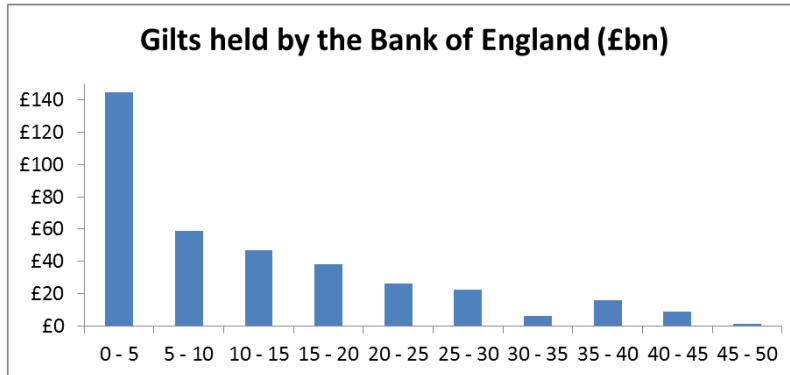
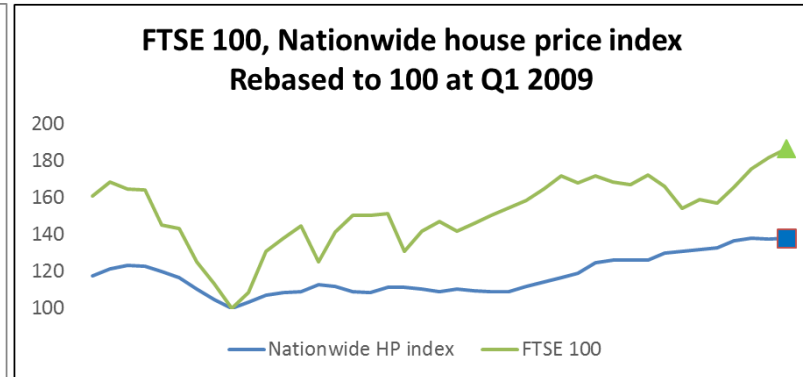
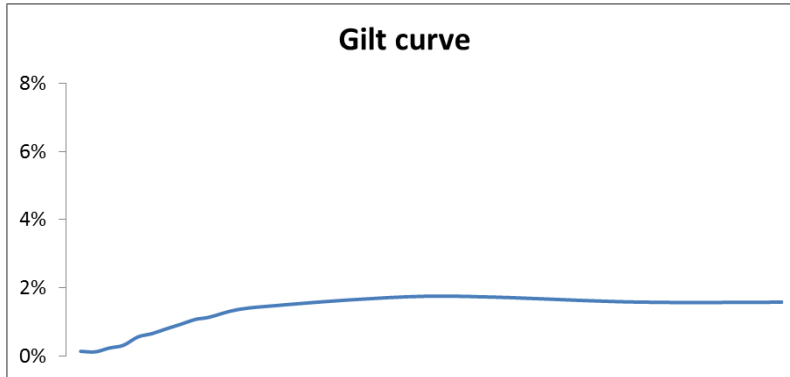
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# Q1 2016



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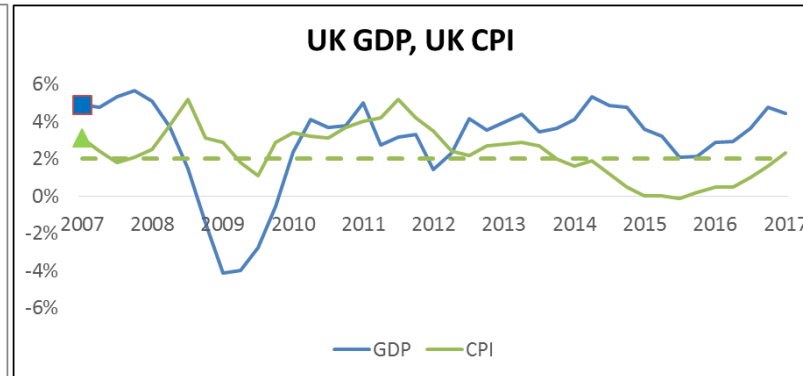
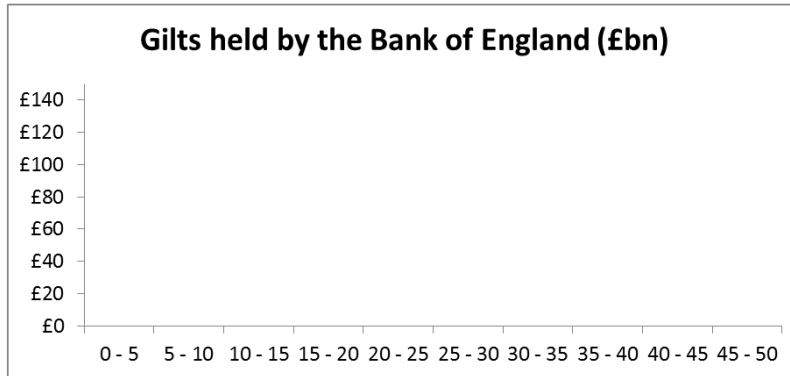
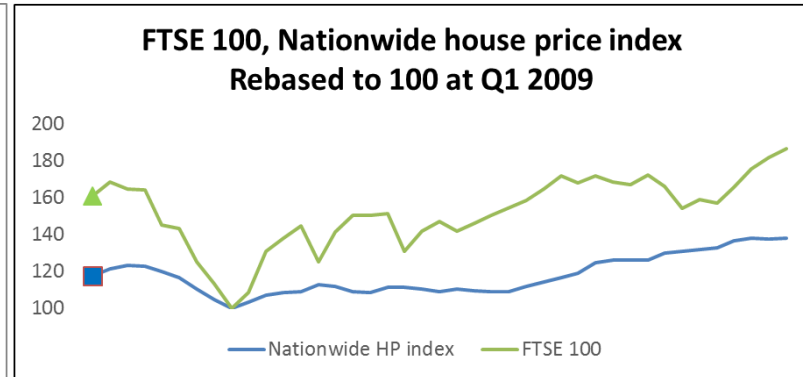
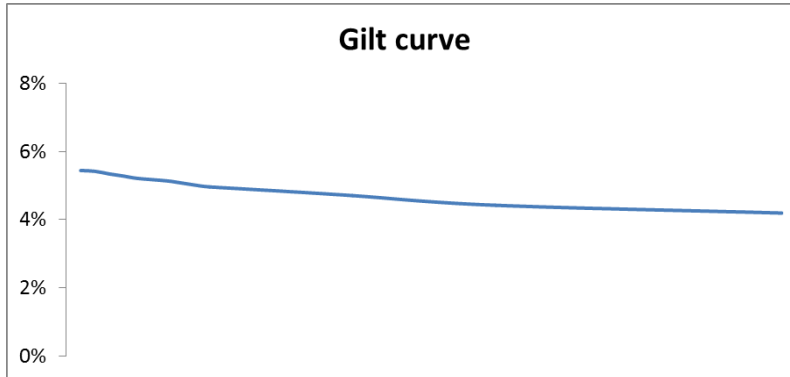


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## Q1 2009 – Q1 2017

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

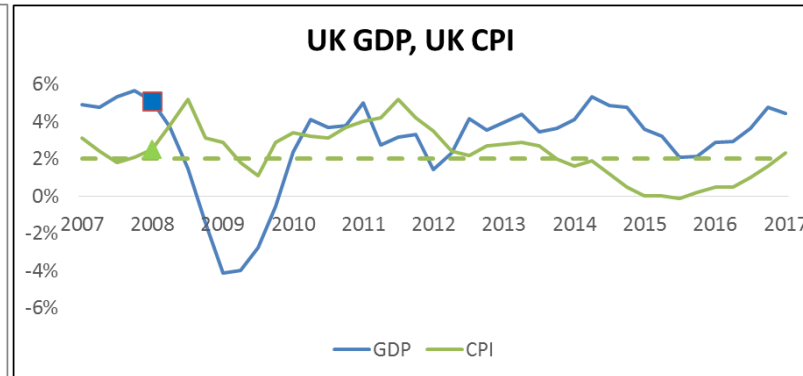
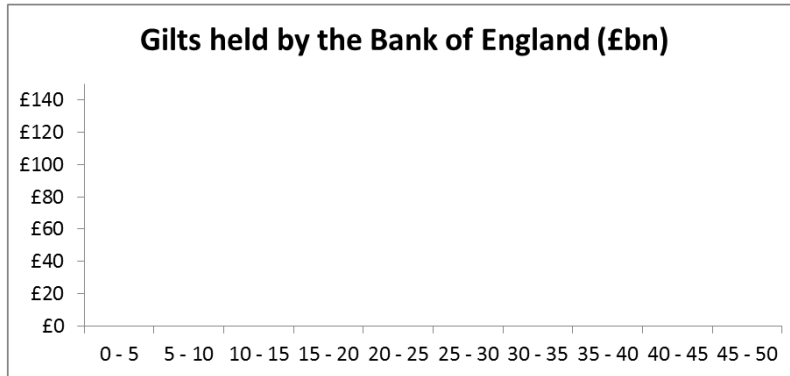
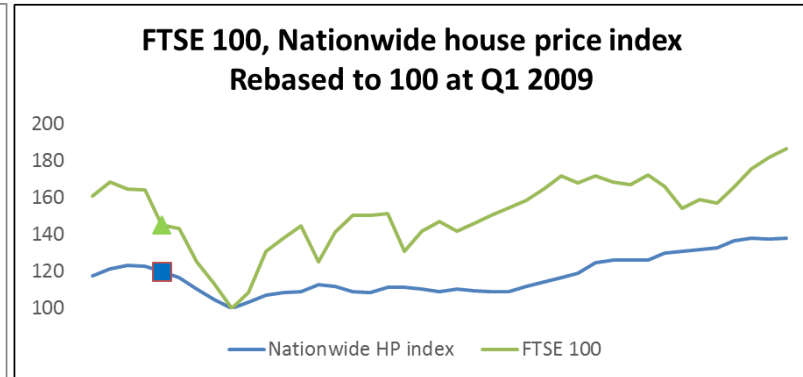
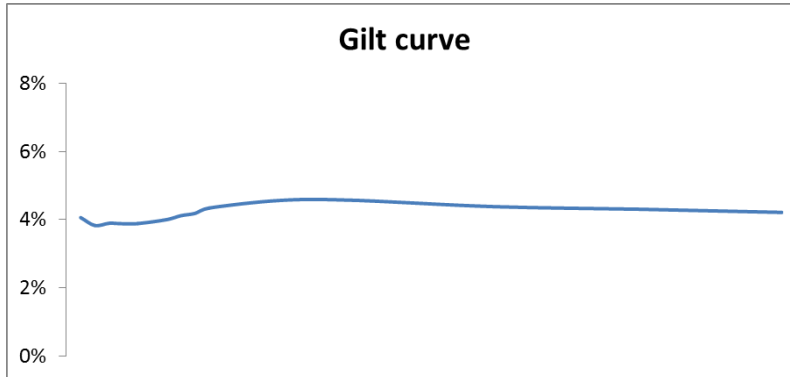




**Q1 2007**



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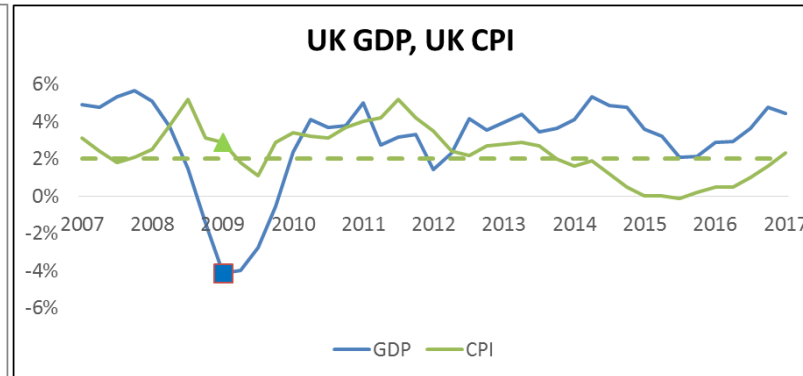
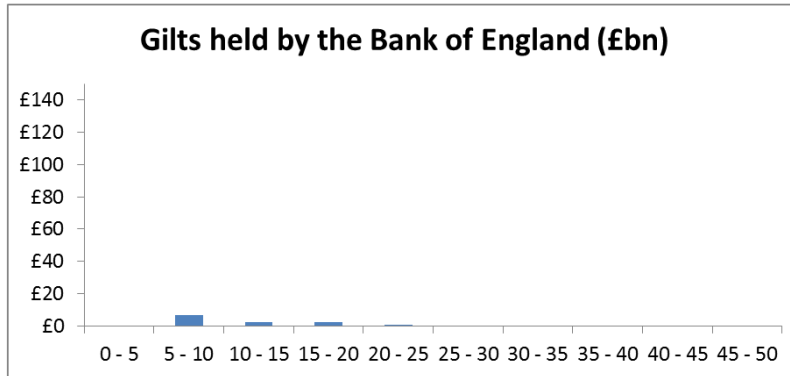
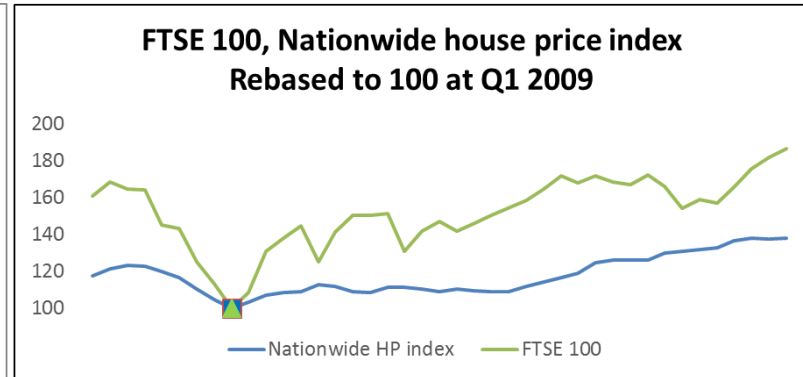
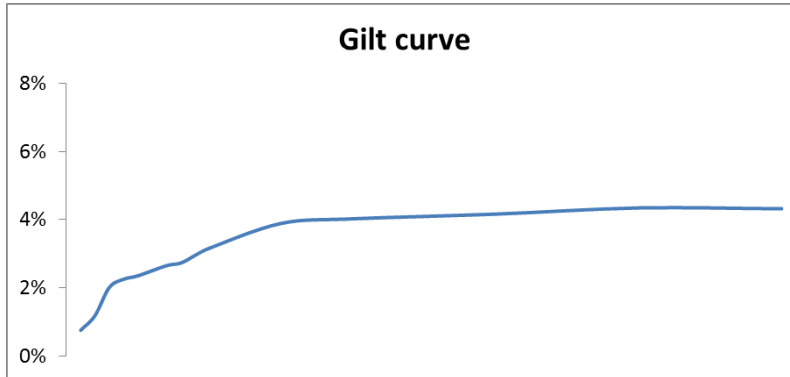


# Q1 2008



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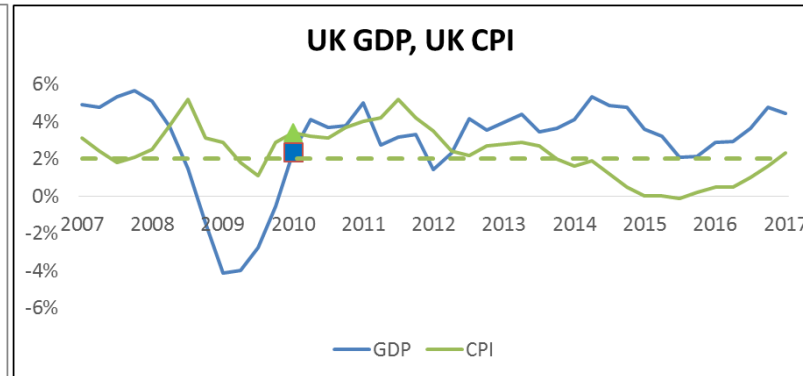
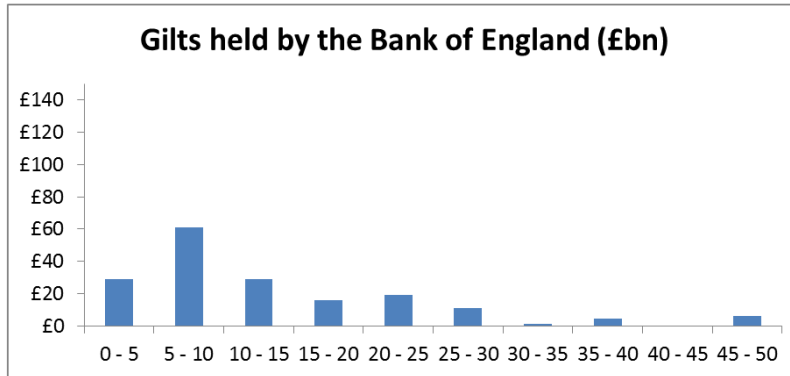
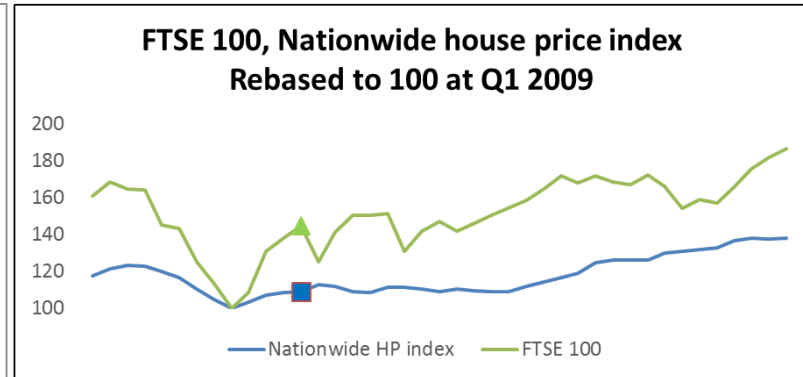
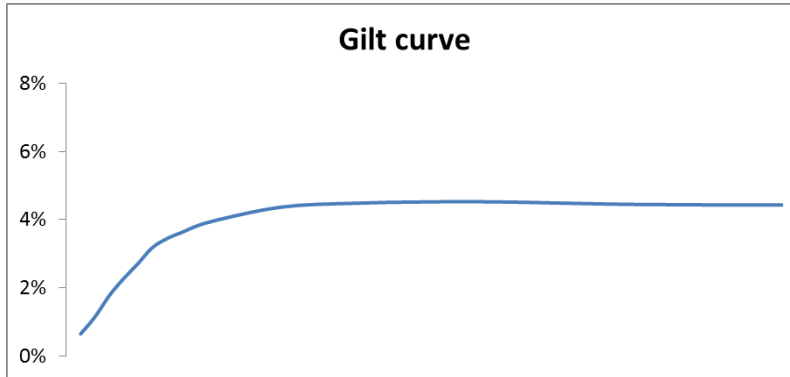




# Q1 2009



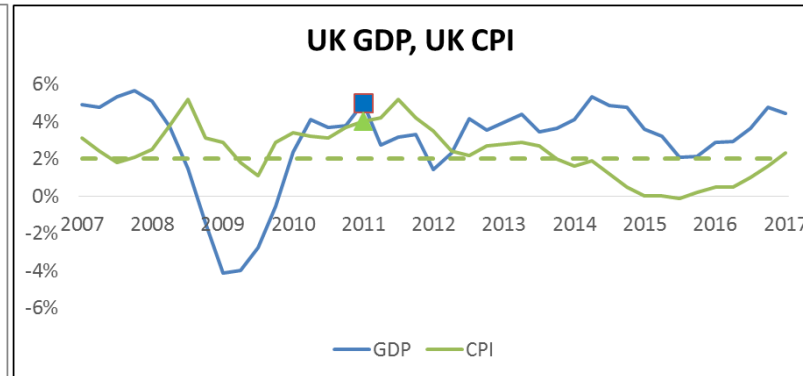
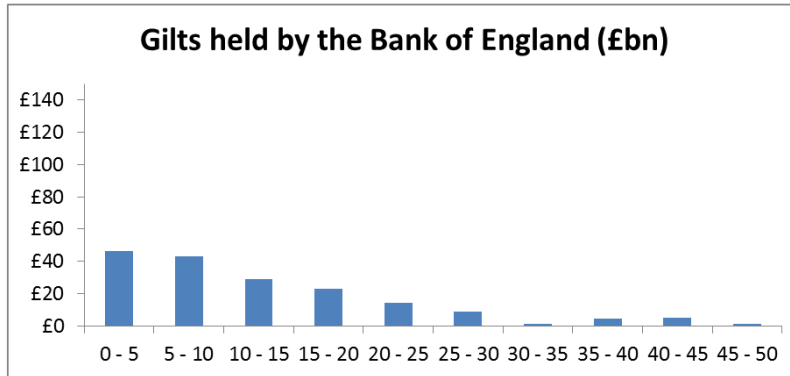
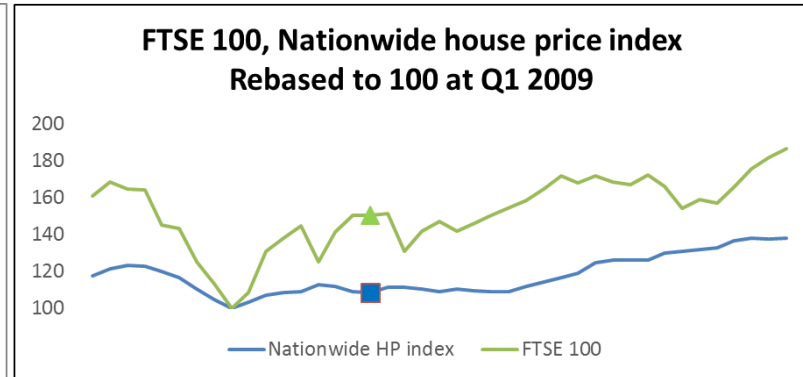
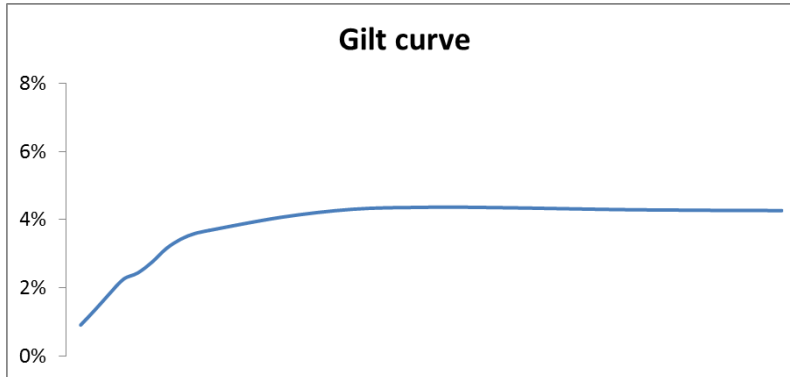
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# Q1 2010



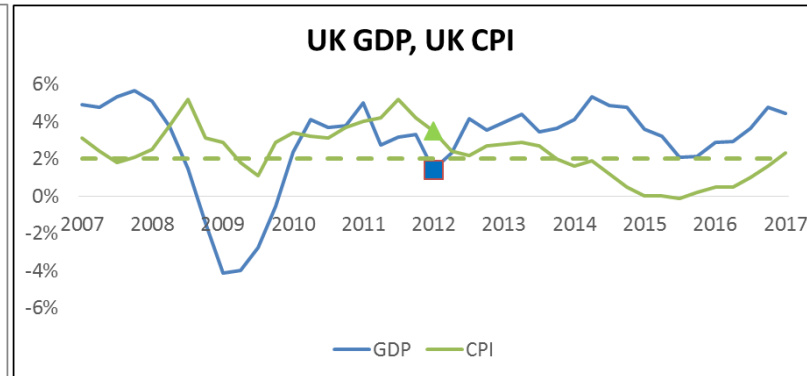
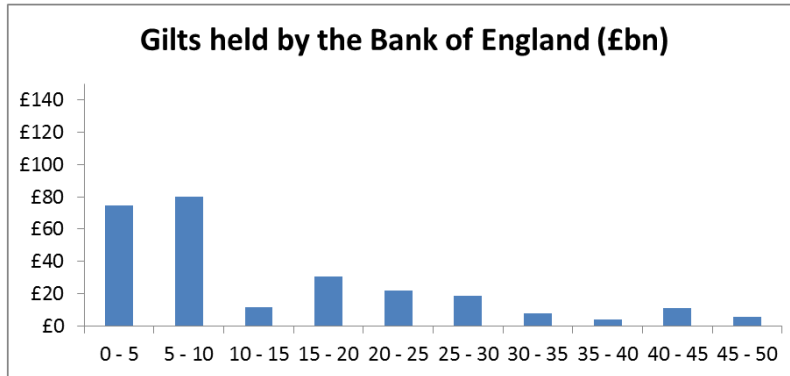
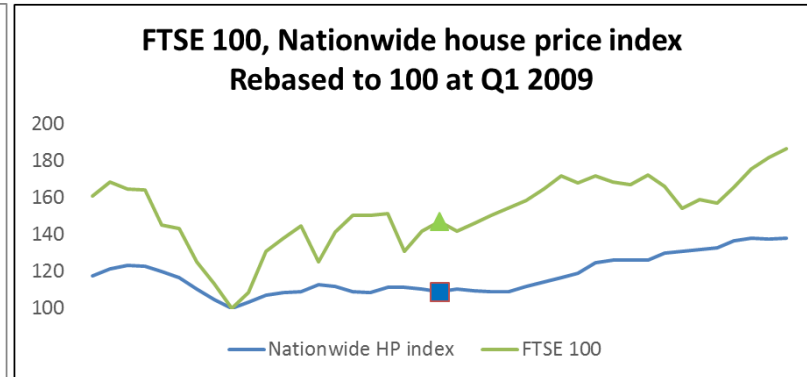
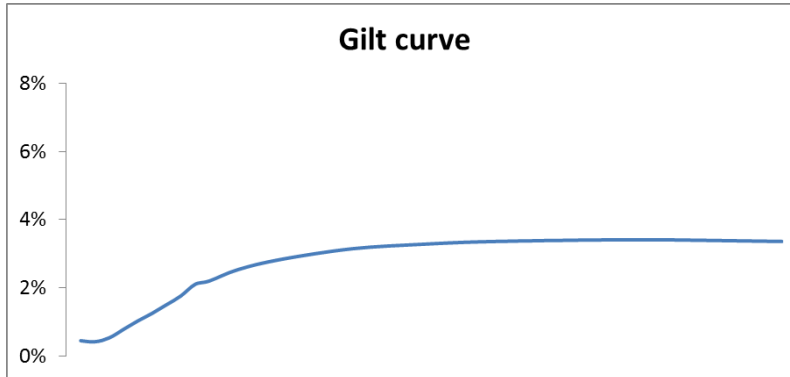
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# Q1 2011



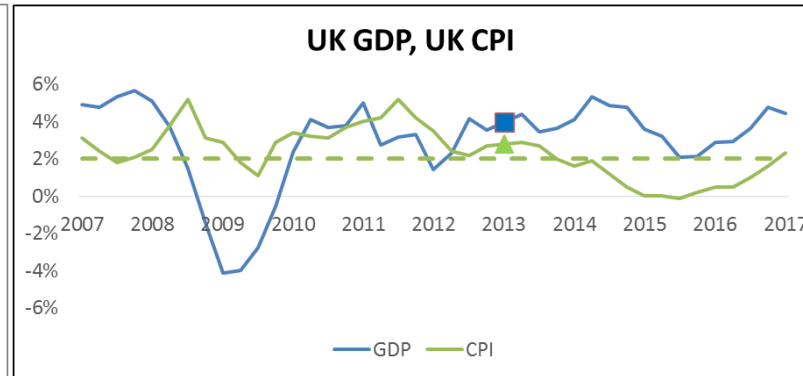
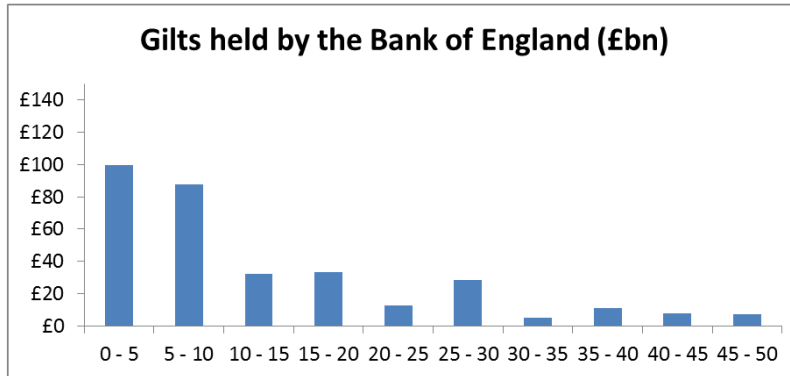
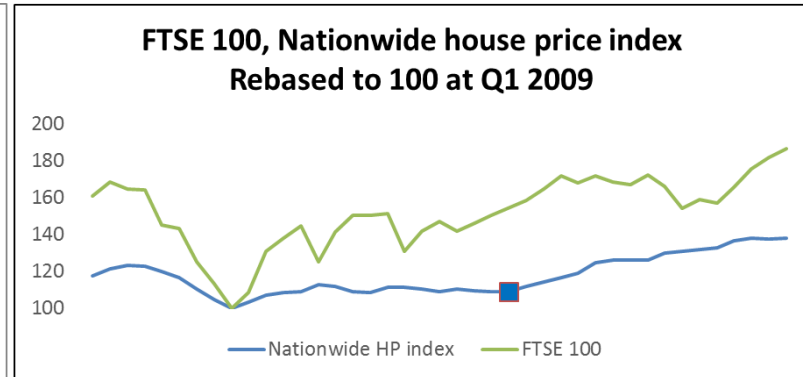
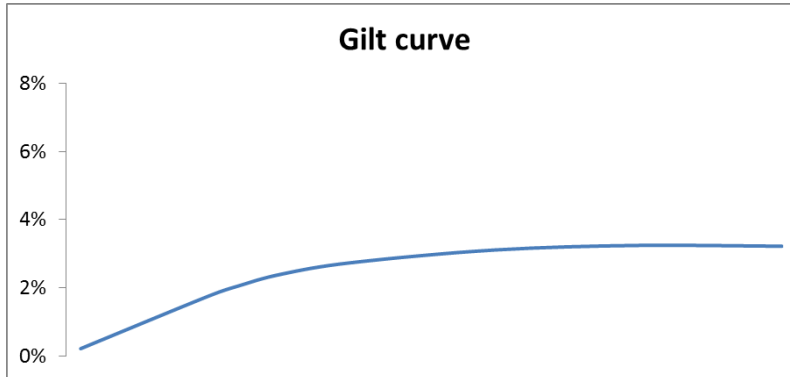
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# Q1 2012



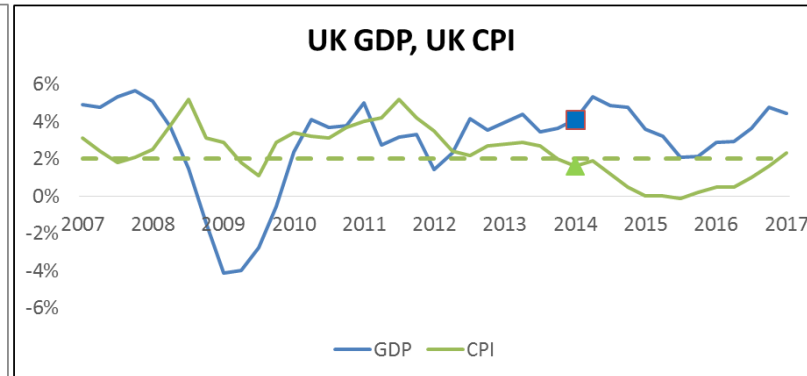
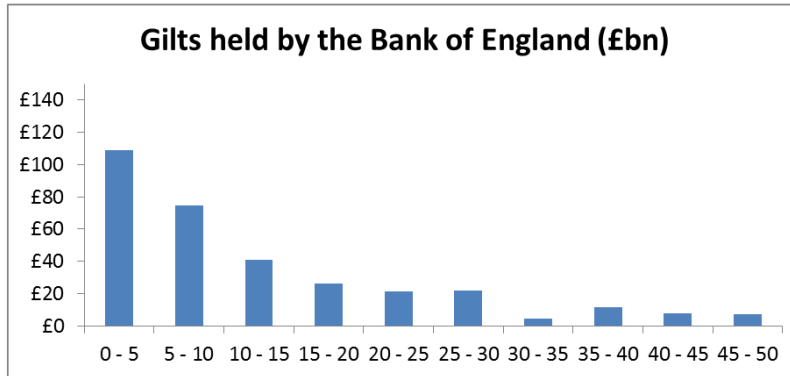
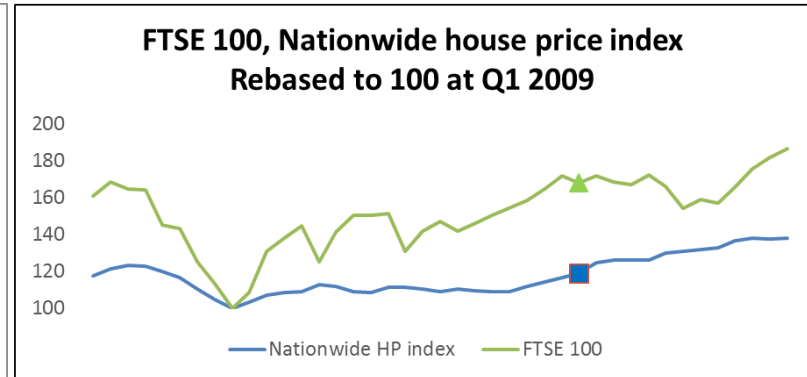
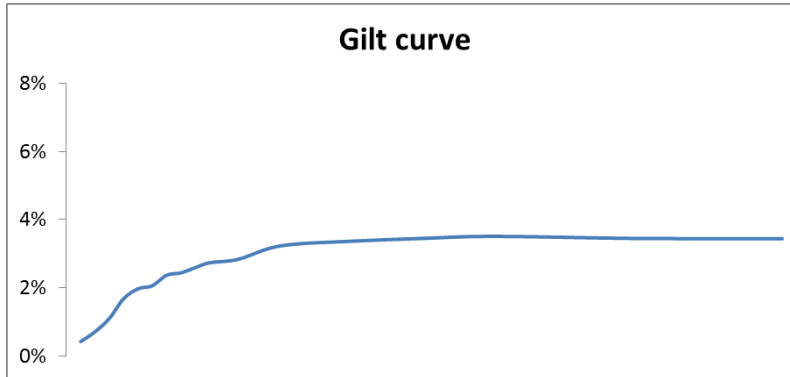
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# Q1 2013



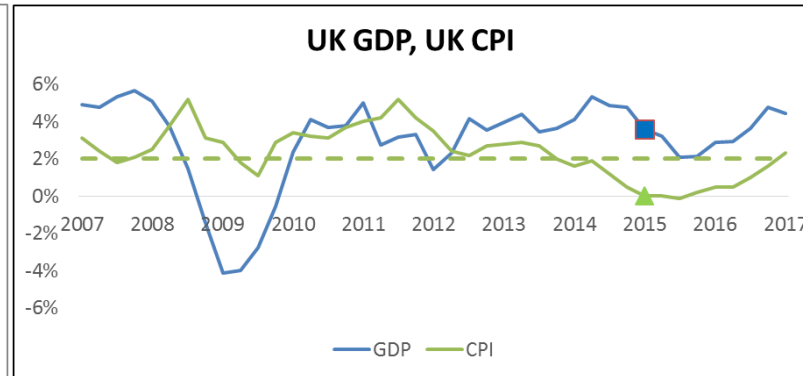
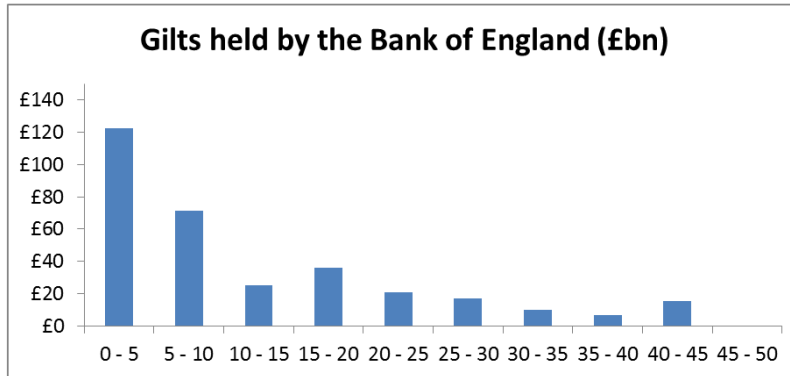
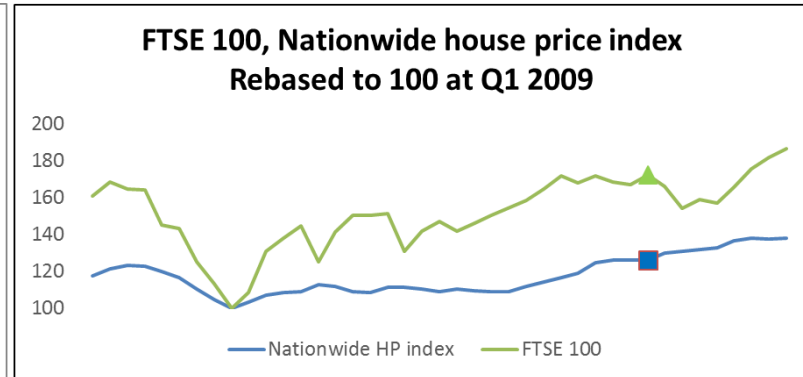
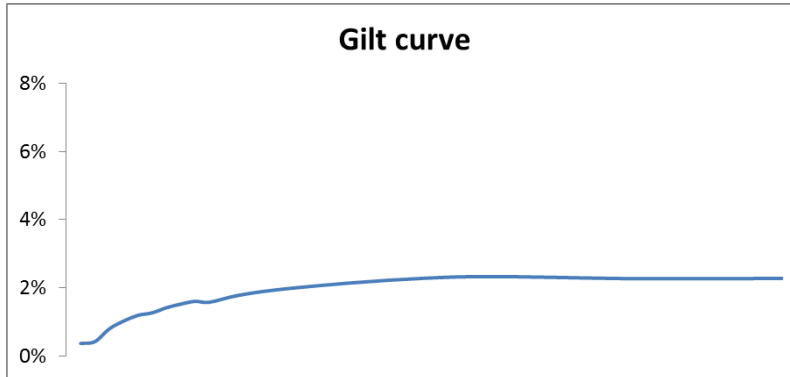
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# Q1 2014



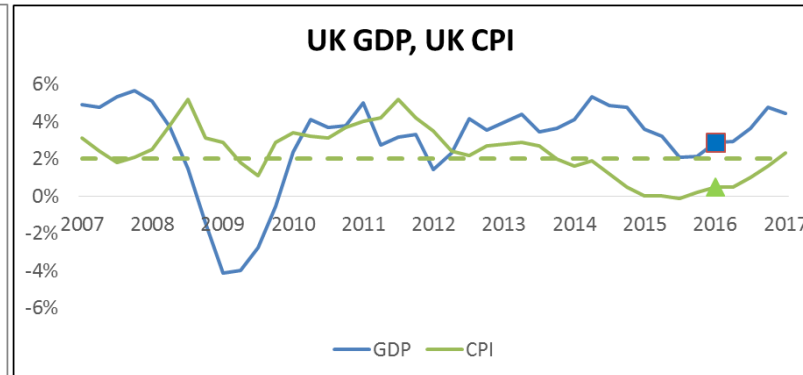
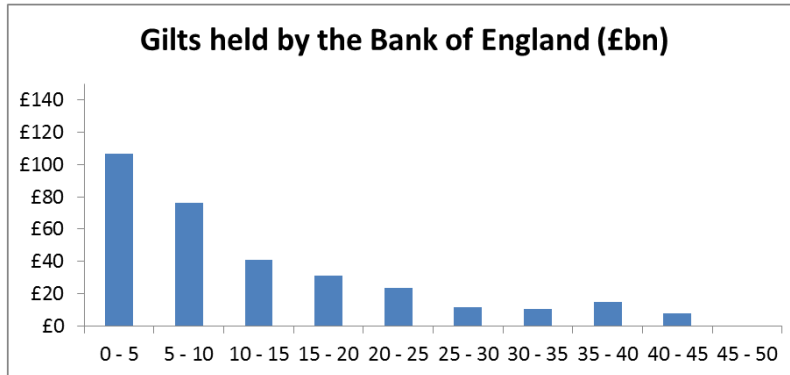
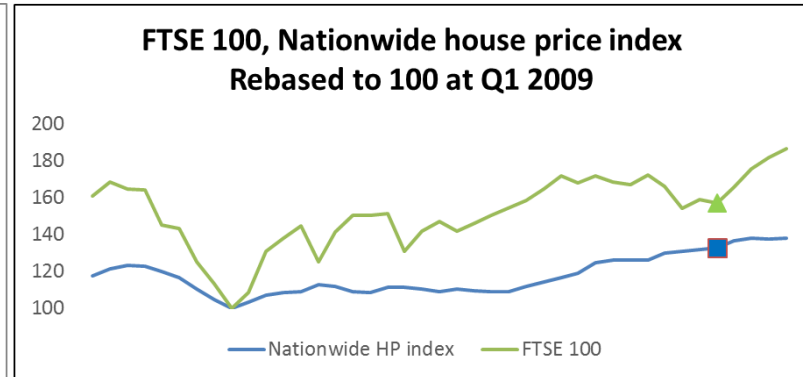
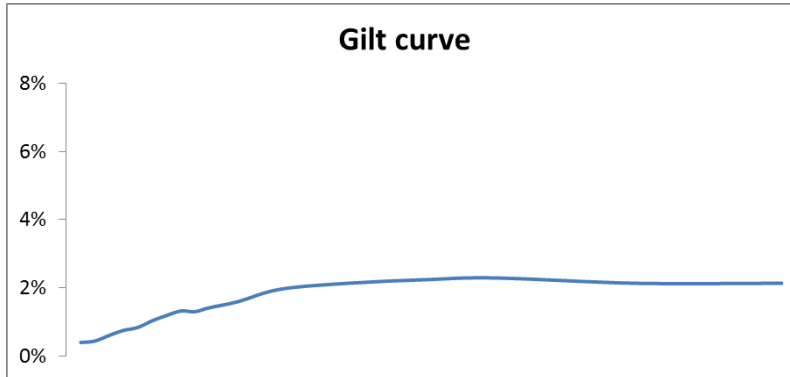
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# Q1 2015



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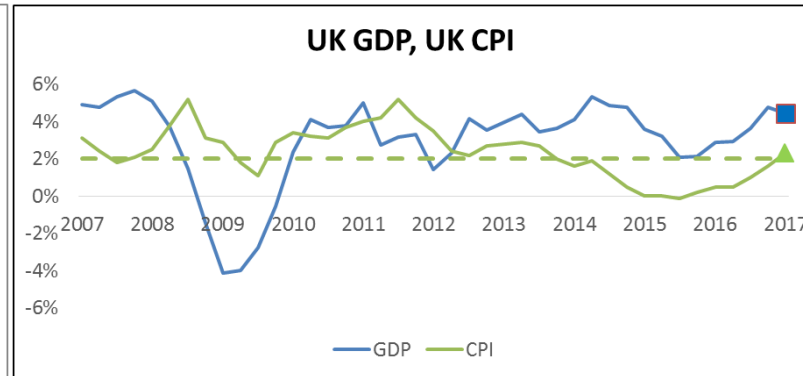
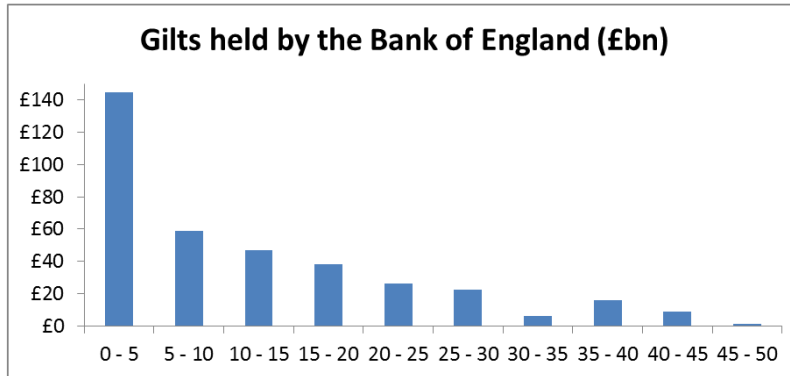
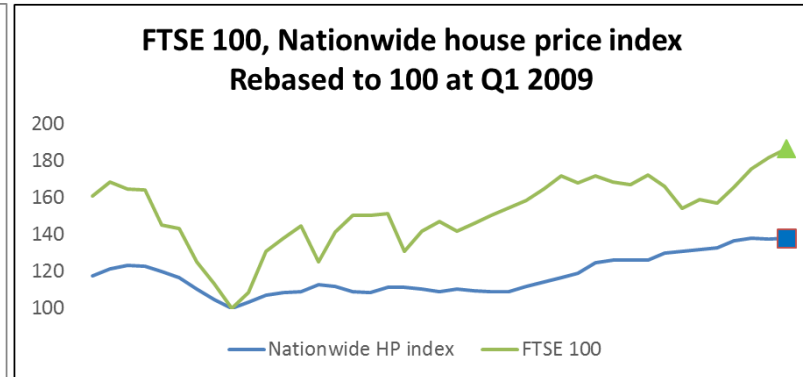
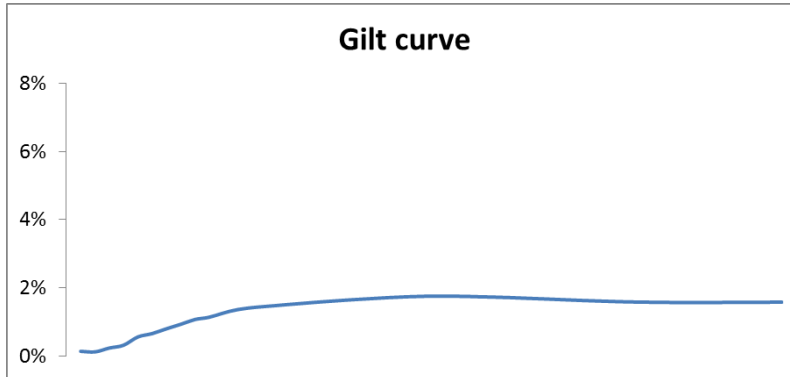


**Q1 2016**



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# Q1 2017



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# 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



# What else did QE bring us?

Average UK debt at £8,000 per person  
(not including the mortgage)

Survey reveals 6m Britons fear never being debt-free with 25% struggling to make ends meet and 62% worried about personal debt levels

Young people are borrowing to cover  
basic living costs, warns City watchdog

FCA boss raises alarm over growing debt burden of young people in UK as number of insolvent 18- to 34-year-olds in the UK jumps by a third

IMF warns that using consumer debt to  
fuel growth risks crisis

International organisation joins Bank of England in voicing concern over high levels of household borrowing



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# What else did QE bring us?

- Debt
- Dependency



# What else did QE bring us?

- Debt
- Dependency
- Market distortion



# 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



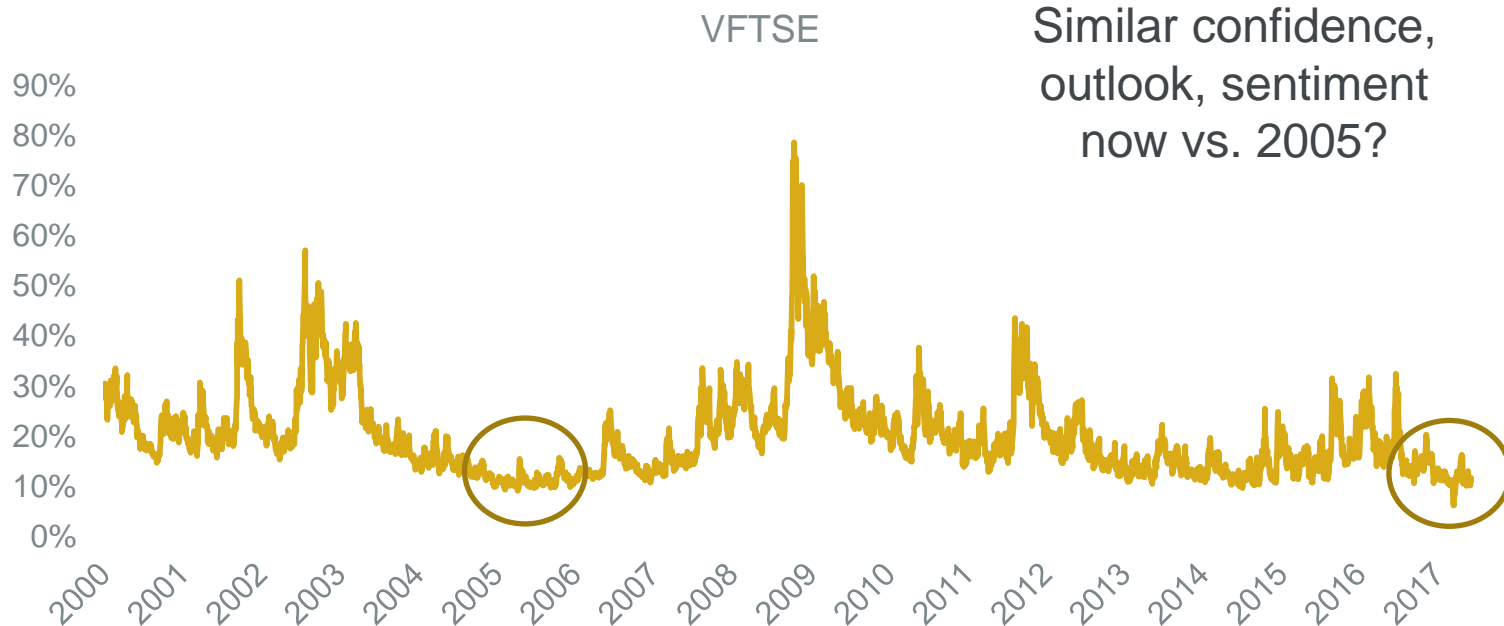


# The (extreme) search for yield

- In 2016 Austria sold 2bn Euros of 70-year debt at 1.5%
- **In 2017 Austria sold 3.5bn Euros of 100-year debt at 2.1%**
- 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



# Yet the market is (implied) calm



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# What else did QE bring us?

- Debt
- Dependency
- Market distortion
- Pension deficits



# What else did QE bring us?

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



# 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?

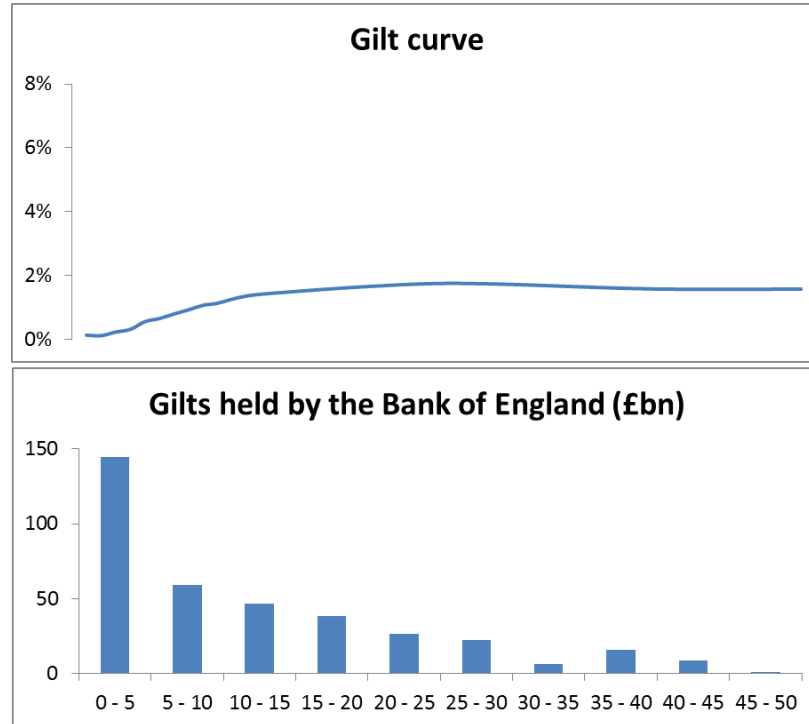


# How will QE unwind?



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# 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



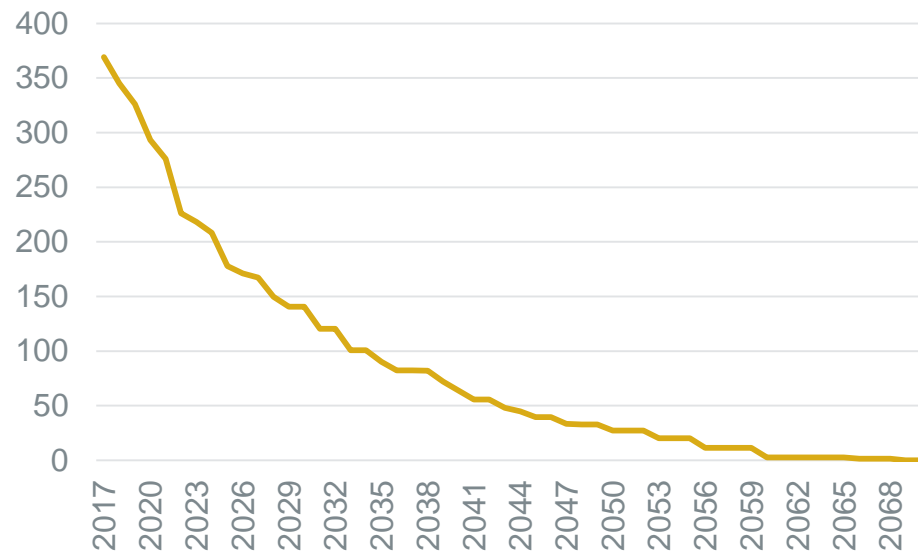


# The options

- 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?



# 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*



# What the Bank of England has done

- Q3 2017
- **Base rate 0.25% ->0.50%**

*The Committee also voted unanimously to maintain the stock of UK government bond purchase*



# Monetary policy and pensions



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# What does the Bank of England think about pensions?



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# What does the Bank of England think about pensions?



Andy Haldane

Bank of England chief  
economist

Next governor?



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# What does the Bank of England think about pensions?

- May 2016

*I confess to not being able to make the remotest sense of pensions*



# What does the Bank of England think about pensions?

- August 2016, on the best option for retirement

*It ought to be pensions but it's almost certainly property*



# What does the Bank of England think about pensions?

- Assets matter.....
- Liabilities don't?



# What does the Bank of England think about pensions?

| Publication  | Word count on <i>asset</i> | Word count on <i>liability</i> |
|--|----------------------------|--------------------------------|
| <i>Quantitative easing</i><br><br>Quarterly Bulletin Q2 2009   |                            |                                |
| <i>The United Kingdom's<br/>quantitative easing policy:<br/>design, operation and impact</i><br><br>Quarterly Bulletin Q3 2011 |                            |                                |



# What does the Bank of England think about pensions?

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# What does the Bank of England think about pensions?

- Essentially ignored
- Not part of the mandate

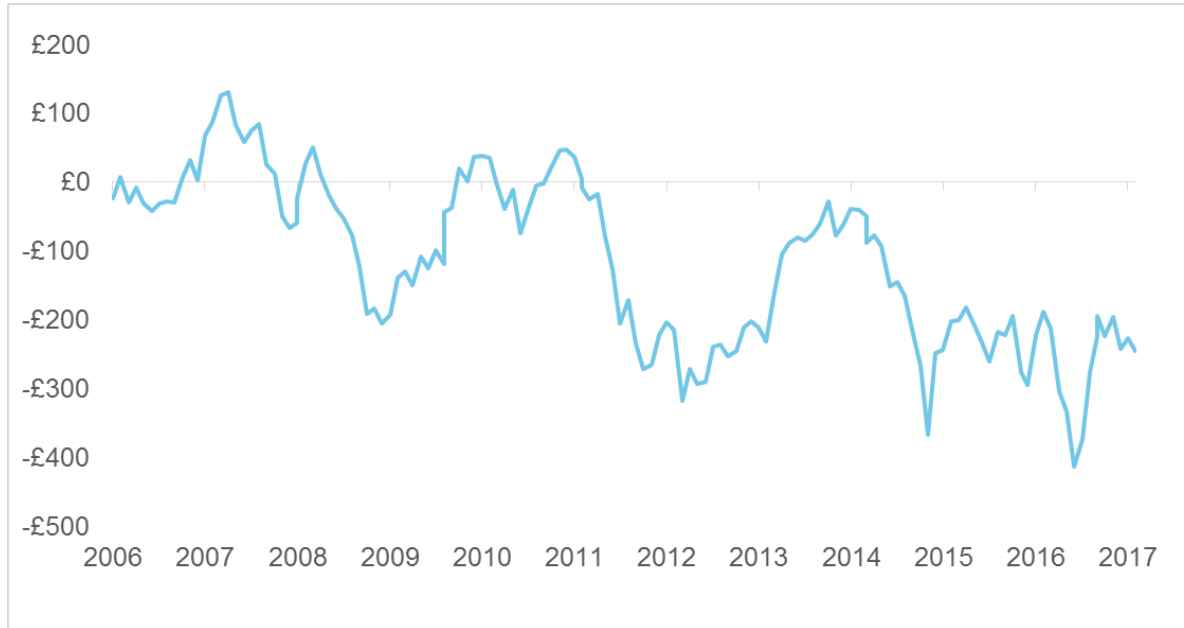


# The impact of QE on pensions



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# The impact of QE on pensions

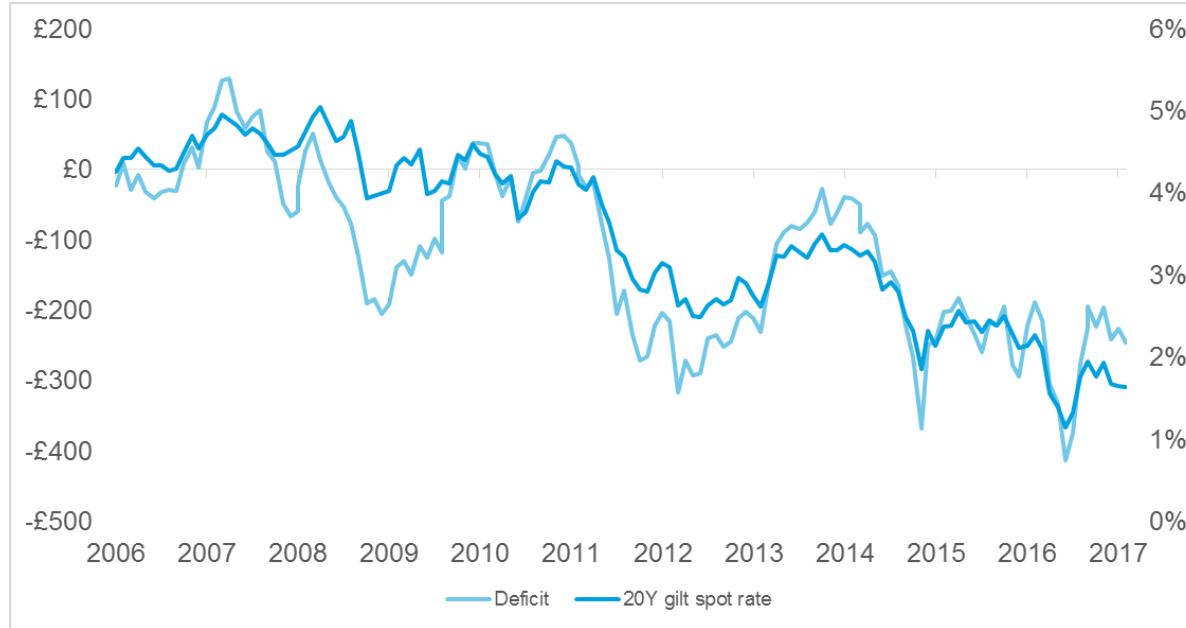


PPF estimate of  
aggregate DB  
deficits (£bn)



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# The impact of QE on pensions



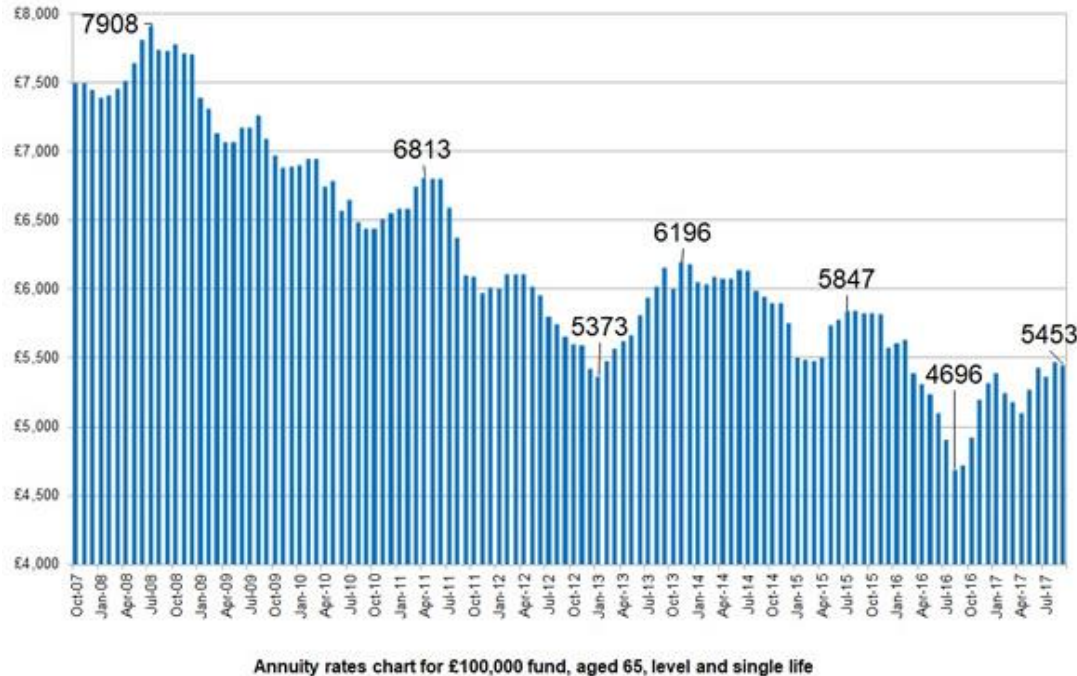
PPF estimate of  
aggregate DB  
deficits (£bn)

+ 20Y gilt spot  
rate



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# The impact of QE on pensions



Falling annuity rates

Source:  
[sharingpensions.co.uk](http://sharingpensions.co.uk)



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# The impact of QE on pensions

- How sustainable and secure are DB schemes?
- Subject of recent government consultation



# The impact of QE on pensions

- How sustainable and secure are DB schemes?
- Subject of recent government consultation
  - Broadly affordable
  - Some schemes may struggle



# The impact of QE on pensions

- How sustainable and secure are DB schemes?
- Subject of recent government consultation
  - Broadly affordable
  - Some schemes may struggle
- **Affordable but at what cost?**





# The impact of pension costs on Bank of England's aims

- An implicit assumption that it **doesn't** impact Bank's primary aims
  - *To promote the good of the people of the United Kingdom*
  - *(via) sustainable growth in output and employment*



# The impact of pension costs on Bank of England's aims

- Inflation ratchet in DB schemes
- The end of secure retirement?
- Diverting business investment and wage growth



# Is there another way?



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# 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? | No – CPI tells you little in isolation<br>And 2% is increasingly arbitrary |
| Is monetary policy a suitable tool?  |  |
| What did QE bring us?                |  |
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# Is there another way?

| Question                             | Answer   |
|--------------------------------------|--|
| Does the current mandate make sense? | No – CPI tells you little in isolation<br>And 2% is increasingly arbitrary |
| Is monetary policy a suitable tool?  | To lower inflation, yes<br>To raise inflation, it's a blunt tool           |
| What did QE bring us?                |  |
| How will QE unwind?                  |  |



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| What did QE bring us?                | Exactly what it promised. And more...<br>Debt, dependency, distortion, new risks |
| How will QE unwind?                  |  |



# Is there another way?

| Question                             | Answer   |
|--------------------------------------|--|
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| What did QE bring us?                | Exactly what it promised. And more...<br>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
- Narrow view



# The issues that central banks need to address

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



# The issues that central banks need to address

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



# What needs to be change?

- Genuine oversight and accountability



# What needs to be change?

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



# 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



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# Questions

# Comments

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