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How low can you go? – speech by Andy Haldane

In a speech to the Portadown Chamber of Commerce in Northern Ireland Andy Haldane, the Bank of England's Chief Economist, discusses the future of money and the future of monetary policy.

Andy first considers the need for central bankers to explore ways of conducting monetary policy at the zero lower bound. He then turns to the outlook for the UK economy today, setting out his stance that "the case for raising UK interest rates in the current environment is… some way from being made."

"Following the global financial crisis, short-term interest rates fell sharply in a great many countries". Monetary policy makers must now consider how to deal with the risk that global rates remain persistently lower. "Central banks may then need to think imaginatively about how to deal on a more durable basis with the technological constraint imposed by the zero lower bound on interest rates."

Andy explores three possible solutions. The first "would simply be to revise upwards inflation targets" giving central banks extra interest rate "wiggle room". However, any such increase could have a negative effect on inflation expectations which could in turn "be damaging to macro-economic stability." It would also be inconsistent with the public's preferences.

Alternatively, unconventional monetary policy tools could be made permanent. "That might mean accommodating QE as part of the monetary policy armoury during normal as well as crisis times". Although QE does appear to have been "reasonably powerful", it is highly state contingent and its impacts are uncertain; a permanent version could blur the line between fiscal and monetary policy and potentially undermine central bank independence; and, international spill-over effects could have consequences for the exercise of national monetary policy in other countries.

The third and final option for dealing with the ZLB would be charging a negative interest rate on currency, most probably through a state-issued digital currency. "This would preserve the social convention of a state-issued unit of account and medium of exchange… But it would allow negative interest rates to be levied on currency easily and speedily". Many questions remain about how this would work in practice and

whether the public would support the change, but it is an area worthy of further research as it would represent a “great technological leap forward” for money and monetary policy.

Andy ends by turning to the issue of monetary policy today. He explains his view of recent events in Greece and China as “the latest leg of what might be called a three-part crisis trilogy”. While “it is simply too soon to tell how potent contagion from EMEs [emerging market economies] to the world economy will be” few of the headwinds to these economies “seem likely to abate quickly”.

“Against these negative external forces are weighing solid UK domestic demand forces.” But “while the UK’s recovery remains on track, there are straws in the wind to suggest slowing growth into the second half of the year” such as softening employment and surveys suggesting slowing output growth.

In addition, headline UK consumer price inflation is still close to zero and “Even after stripping out food and energy prices… the Bank’s range of core inflation measures average around 1%” leading Andy to state that he is not as confident as he would like “that one percentage point of additional nominal pick-up will be forthcoming over the next two years.”

He concludes “were the downside risks I have discussed to materialise, there could be a need to loosen rather than tighten the monetary reins as a next step to support UK growth and return inflation to target.”

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