Mark Carney: One Bank Research Agenda – Launch Conference

Opening remarks by Mr Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, at the Launch Conference for the Bank of England's One Bank Research Agenda, London, 25 February 2015.

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I am delighted to open the Launch Conference for the Bank of England's *One Bank Research Agenda* – an ambitious and wide-ranging framework to transform the way research is done at the Bank.

The Agenda aims to improve the coordination of our research across all policy areas, to make the best use of our data, and to cultivate an extensive research community that spans the Bank and beyond.

The Bank of England has a single timeless mission: to promote the good of the people of the United Kingdom by maintaining monetary and financial stability.

To borrow from Keynes, to deliver that mission we must study the present in the light of the past for the purposes of the future. And we must do more. Our default cannot be Keynes' "madmen in authority… distilling their frenzy from some academic scribbler of a few years back".[1] We need contemporaneous and open collaboration between researchers and policymakers.

This will require both changes to our research focus such as developing a deeper understanding of the interrelationships between microprudential, macroprudential and monetary policies as well as changes to the way that we perform research at the Bank, including the development of a more open, permeable and policy-driven approach.

In short, we are aiming to transform research at the Bank to the same extent as the Bank's responsibilities have transformed in the wake of the financial crisis.

Transformation of the Bank of England

The central challenge of macroeconomic policymaking in the late 1970s and 1980s was the fight against inflation. In no small part due to my predecessors, particularly Lord King, we have today a regime for maintaining monetary stability that is both democratically legitimate and highly effective. It rests on clear remits, delegated by Parliament, sound governance arrangements to support independence, and effective transparency of policymaking. And it provides valuable lessons for the conduct of other policy functions.

Despite these successes, in both theory and practice, a healthy focus on price stability had become a dangerous distraction. The financial crisis was a powerful reminder that price stability is not sufficient for macroeconomic stability. It exposed the convenient fiction that finance is a veil. And we were taught that the dynamics of lending markets are as important as those of labour markets for our shared prosperity.

In response to these painful lessons, the Bank of England has been bestowed with enormous new responsibilities by Parliament. They now span monetary policy, macroprudential policy, and microprudential supervision. They include responsibility for the United Kingdom's bank notes; its payments systems; oversight of financial markets infrastructure and resolving failed institutions. To help fulfil its mission the Bank has core roles in Europe, at the G20 and at the Financial Stability Board.

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[1] In Ch. 24 of Keynes, J M (1936), *The General Theory of Employment, Interest and Money*, Macmillan Cambridge University Press.

Having monetary, macroprudential, and microprudential policy under one roof makes gains from trade possible. It is our duty to exploit complementarities, synergies and economies of scope to maximise our impact by working together. To do so, we need research. And to some extent, research needs us.

The need for research

The way central banks have sought to achieve their objectives – the *practice* of central banking – has frequently moved ahead of the *theory* of central banking.

Theory, in turn, subsequently catches up, and enriches and refines practice.

The history of central banking is replete with examples. Tacit knowledge has often been more instrumental in determining policy outcomes than insights from formal research. Sometimes this works, as in Bagehot's "dictum" (to lend freely at a penalty rate against good Montague Norman's "never explain, never excuse".[2]

Research has meant that some modes of operation, like Norman's, have rightly fallen by the wayside. It has helped nuance others, like Bagehot's. And it guides us as to which practices to retain, reinforce and enhance, and which should be discarded.

The practice of monetary policy in the Great Moderation is another example. It informed theorising and research on Inflation Targeting. And, in turn, through trial, error and refinement, research has helped inform policy with empirical insights and workhorse models.

In the theoretical space, this process led to Woodford's dictum that in modern central banking very little else matters beyond expectations.[3]

In contrast, the practice of central banking in a messy real world where people use various heuristics, including rational inattention, has shown the limitations of such logical extremes.

Research showed how central bank transparency and accountability make essential contributions to policy effectiveness, in a way that is complementary to ensuring central banks have democratic legitimacy. That remains an important insight in the era of enlarged and empowered central banking.

Practice moved ahead of theory; theory caught up and refined practice. And the effectiveness of policy improved as a result.

The crisis has meant practice has once again leapt ahead of theory. During its depths, the lessons of history and insights from psychology were arguably more valuable than precisions of dynamic programming. Our workhorse models didn't have financial sectors; meaning questions of financial stability were not even asked, let alone answered. A great deal of improvisation was required to avoid a second Great Depression.

It is vital that we draw on the experience from the crisis to rethink the way we understand the economy, the financial system, and the institutions we supervise.

To do so, we need not only to study recent history more deeply but also to apply formal methods to refine our depictions of economic dynamics, as well as the policy tools we have to shape those dynamics in socially desirable ways.

We need to catalyse thinking on new approaches towards policies that have assumed greater importance since the crisis from macroprudential policy to bank resolution.

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2 See Bagehot, W (1873), *Lombard Street: A Description of the Money Market*; and Boyle, A (1976), *Montagu Norman: A Biography*, London: Cassell.

3 See Woodford, M (2005), "Central bank communication and policy effectiveness", *NBER Working Paper* No. 11898, December.

At the Bank of England, our enhanced research function, including a new Research Hub, will bring together staff and thinking from across the institution creating a two-way flow between research and policy. It will seek to foster a shared understanding of the frontier of policy possibilities amongst colleagues and ensure that the insights gained in one policy arena can benefit others.

But these efforts will not succeed if they are confined to the corridors of Threadneedle and Moorgate.

The Bank recognises that we need to do more to reach out to the wider research community. Policymaking can benefit tremendously from advances in all fields of economics and finance; from psychology to epidemiology; from computer science to law. That is why I am pleased to see such a diverse range of discussants and attendees at the conference today.

In order to focus the conversations we are being clear about the key questions that interest us, as policymakers, the most.

Let me now turn to those. Our *One Bank Research Agenda* is structured around five themes which span all aspects of central banking.

The themes are broad. That reflects the diversity of our agenda. They focus on the interactions and intersections between policy areas. They emphasise new challenges and new directions, while recognising that familiar questions facing central banks remain no less important. Today's conference is organised around them.

The first theme covers "policy frameworks and interactions"

The re-emergence of macroprudential instruments as part of the policy armoury raises fundamental questions about the interaction of monetary policy, macroprudential policy, and microprudential policy.

It is essential to improve our understanding of the relationship between credit cycles and systemic risks. Since credit market developments both affect and reflect potential growth in the broader economy, they – and macroprudential measures to influence them – require careful study by financial and monetary policymakers alike.

The advent of a new, enhanced policy toolkit raises vital questions about the effectiveness of individual policy tools; their joint operation; and how they interact domestically and across borders.

The second theme covers "evaluating regulation, resolution, and market structures"

The financial crisis precipitated a radical overhaul of the approach towards regulation, supervision and resolution. Regulatory policies have shifted from a near-exclusive focus on microprudential resilience to a more balanced emphasis on minimising systemic risk.

In the whirlwind of essential change, there has been, however, relatively little assessment of the overall effect of reform on the financial system as a whole. Moreover, our understanding of the "system" must extend well beyond the banking sector to encompass the whole of market-based finance.

The interplay between the reform process and the changing nature of financial intermediation also raises fundamental questions about how incentives and market structures might evolve and what policy might need to do to keep up.

The third theme covers "Policy operationalization and implementation"

The practice of central banking constantly underscores that implementation and communication of policy can be as important as its design.

During the crisis central banks around the world made extensive and imaginative use of their balance sheets in pursuit of their objectives.

This extraordinary range of policy responses provides an unparalleled opportunity to take stock of what worked, and why. As Ben Bernanke observed "the trouble with QE is it works in practice, but it doesn't work in theory." Understanding better the transmission mechanisms of QE, and the extent to which they are state dependent, can provide enormous insights to its effectiveness as a policy tool specifically, as well as the formation of agents' expectations and the functioning of financial markets more generally.

Recent innovations have not been confined to new tools. As I noted previously, better communication and greater transparency has also made policy more effective.

Transparency has taken centre stage as policymakers sought to restore confidence in the financial system, as they conducted and published stress test results to create more transparently resilient banks; and as they gave guidance to clarify their reaction functions. Recently, research informed the recommendations of the Warsh Review into what we could do to enhance monetary policy transparency here at the Bank of England.

This research theme continues in that vein by asking what more might be done to enhance effective transparency in all areas of policy.

The fourth research theme covers "New data, methodologies and approaches"

Increasing amounts of data – structured and unstructured, current and historical – are available on almost every aspect of the economy and the financial system. That holds great promise. Computing power has transformed our economies; it needs now to be harnessed to transform our understanding of them.

Theoretical and methodological techniques continue to advance. In some cases that will mean measurement ahead of theory. That is one way to advance. In the short term, a black box could be better than none, and with time the patterns it reveals could prompt a greater understanding of the underlying forces. Recall that Kepler needed to uncover the empirics of planetary motion before Newton could conjure the theory of celestial mechanics.

It is important to exploit developments in advanced analytics of large data sets to formulate better policy. They'll improve our understanding of household and corporate behaviour, the macroeconomy and risks to the financial system. They need to be harnessed to enhance our forecasting and stress testing capabilities.

To complement this theme, we will release historical data sets including detailed breakdowns of the Bank's inflation expectations survey, our Agents' company visit scores, and very long back-runs of key economic and financial variables. This is one of the ways we will look to increase the permeability of our research. We are seeking also new ways to visualise and analyse the increasingly rich information sets that are available.

The fifth and final research theme covers the "Response to fundamental changes"

Fundamental technological and structural trends will have a significant bearing on economic dynamics.

Although they are likely to play out over a period that is longer than the Bank's typical policy horizon, these trends will have profound implications for central banks.

They include changing demography, increasing longevity, inequality, climate change, the increasing importance of emerging economies and the development of digital currencies.

By affecting a range of phenomena – from the evolution of real interest rates to risks to the financial sector to the future of money and banking itself – all of these trends have the potential to re-shape our policy challenges. We need research to set us on the front foot to face them.

Competitions

Before concluding, to catalyse interest in the One Bank Research Agenda, I am delighted to announce that today the Bank of England is launching two competitions.

The first is on Data Visualisation. To coincide with the release of the new Bank data sets, we want to see what novel insights they can yield.

The visualisation could be a static description of an interesting pattern or relationship in the data or the creation of an interactive app. Entrants are free to focus on whatever they like, as long as it employs some of the newly available data in some way.

The second competition is for the best research paper – the “One Bank research” competition. We are particularly keen to engage early career researchers across the academic world. For our inaugural competition, the paper should be on some aspect of “The interaction between microprudential, macroprudential, and/or monetary policy”.

The winners of each competition will be decided by separate judging panels of Bank staff and external academics. The prize for both competitions will be £5,000.

Further details on how to apply are now live on our website.

Conclusion

Economies are complex, dynamic and constantly evolving systems, underpinned by social interactions and behavioural change; shaped by fundamental forces like technology and globalisation; and supported – or at times disrupted – by finance.

Policymakers need research to help understand these phenomena and to craft our responses to them. And research can make some of its most effective contributions by addressing the priorities of policymakers.

By focussing on a clear set of research priorities, by opening up our datasets, and by creating tighter links between policymakers and researchers, both within the Bank and across the broader research community, we can all help advance the Bank’s mission – promoting the good of the people of the United Kingdom.

Thank you.