David Prosser: Adviser to Bank gets even more contrary

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Outlook Adam Posen, one of the external members of the Monetary Policy Committee, has been taking a contrary stance for some months now, warning that unless the Bank of England begins a second round of quantitative easing, the UK economy will slip back into a downturn damaging enough for the effects to be felt for a generation.

The lecture that Mr Posen gave yesterday to the Cato Institute in Washington was, however, contrary for a whole different reason. The American economist has just driven a coach and horses through one of the top priorities of regulatory reform since the credit crisis.

Around the world, policymakers are in the middle of struggling to work out how regulation might be recast so as to give them tools to intervene if and when they think an asset price bubble is in danger of inflating.

In the UK, the plan is to have a Financial Stability Committee operating alongside the MPC on which Mr Posen serves, which would advise the Bank of England on threats to the stability of the financial system – to spot those asset bubbles, in other words.

Mr Posen, however, spies a couple of problems. First, he simply does not believe it is possible for anyone to identify such bubbles, at least not in time to do anything about them. Second, he points to evidence suggesting that these booms infrequently lead to busts. Having looked at 42 property booms and 50 stock market booms, only 16 of the former and 12 of the latter were followed by a bust within two years, he says.

In other words, even if you can spot a bubble, which you can't, bursting it may be unnecessary (and will obviously have adverse effects on those caught up in the boom). It's another hand-grenade lobbed by Mr Posen at the Bank of England he advises, and to everyone else dreaming of a more stable financial system.