Select Committee on Economic Affairs

Corrected oral evidence: Annual evidence session with the Governor of the Bank of England

Tuesday 13 October 2020

3 pm

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Members present: Lord Forsyth of Drumlean (The Chair); Baroness Bowles of Berkhamsted; Lord Burns; Viscount Chandos; Baroness Kingsmill; Lord Livingston of Parkhead; Lord Monks; Lord Skidelsky; Lord Stern of Brentford; Lord Tugendhat.

Evidence Session No. 1 Virtual Proceeding Questions 1 - 15

Witness

I: Andrew Bailey, Governor of the Bank of England.

Examination of witness

Andrew Bailey.

Q1 **The Chair:** Governor, welcome to the Economic Affairs Committee. It is your first meeting as governor. Many congratulations, although it is quite some time since you were appointed. You have been very busy and we very much appreciate you taking the time to be with the Committee this afternoon.

Perhaps I could begin by asking the first question. Does the Bank's central economic forecast still consist of a V-shaped recovery? To what extent have the underlying assumptions in the models changed over the course of the pandemic?

Andrew Bailey: Thank you. It is a real pleasure to be here with the Committee, at least virtually. I have to start by saying that I am somebody who normally avoids using letters to describe patterns of economies, and I will use it to the minimum extent possible. I also recall something my colleague Ben Broadbent said back in the height of the summer when I was telling him about the Bank of England's profile: "If that's true, it's the most lopsided V I've ever seen".

Let me put a bit of substance to it. Clearly, in the spring we saw an extremely—in fact, unprecedented in history, pretty much—rapid and severe fall in output of the economy. It was not particularly surprising to me that we saw quite a strong recovery as the lockdown restrictions were lifted and people were able to resume economic activity to a degree. Essentially, we saw quite a strong recovery.

However, let me make two points about that. First, it is a very uneven recovery. Whatever the aggregate number looks like, and it was a fairly steep and sharp aggregate recovery, it hides a very uneven pattern. It is a story that is well known, because we read about it and hear about it all the time, that some sectors of the economy have recovered much more rapidly than others, and some are still struggling to recover, for well-known reasons.

Secondly, if I look at where we are today, I find the most useful way to do this is to compare back to the economy as it was pre Covid. We think that in aggregate terms at the end of the third quarter—so a couple of weeks ago—it was probably round about 9% to 10% below where it was in the fourth quarter of last year. To give you a comparison, at the end of the second quarter it was about 22% below where it was at the end of last year. That is the rapid element of the recovery. However, let us be realistic: 9% is a very big number. First, any talk of V-shaped recoveries has to be put into perspective; that 9% is a massive shortfall by historical standards. That is the first qualification I would put on it.

The second qualification I would put on it—and here there are different views in the MPC on this—is that my view and what the MPC has said publicly is that the recovery will take time. I have also borrowed a saying, I think from rugby, which is that the hard yards are still ahead of us, and since I first said that back in August, unfortunately that has become even more stark.

Let me finish by explaining why I think that and why I think the V is certainly not the way I see what we face going forward at the moment. First, there has been another wave of Covid. Secondly, as we expected, , while there remain very significant and persistent health concerns, people's behaviour and willingness to undertake economic activity would be cautioned by their degree of concern about the health situation irrespective of the return of Covid.

A final point I would make, which is a very important one and no doubt we will come to it later, is that we saw a very fast recovery, essentially because activity was put on hold and pretty much the same activity returned. There were some interesting and important structural changes. None the less, it was a return of familiar activity.

Now we have to ask to what extent Covid will have a lasting impact, in the sense that there will be structural changes resulting from it, either because there are businesses that cannot survive through however long it takes or, even more fundamentally, there are activities that we used to undertake that we just do not undertake any more and some of which we will not go back to undertaking for the foreseeable future. It is that structural change that is much more difficult in the economic context, because it can lead to persistent unemployment, for instance, and we have to be very focused on that. I hope you can tell from that, that I steer away from this rather simplistic talk about Vs.

The Chair: Thank you for that. I know Baroness Kingsmill will want to explore that issue of long-term structural change later in the afternoon.

Q2 **Lord Tugendhat:** To what extent do you agree, Governor, with the IMF's assessment that advanced economies should not be worried about public debt and should take advantage of the historically low borrowing costs to increase spending on infrastructure? I must say it is an approach to which I am sympathetic, but how do you feel about it?

Andrew Bailey: That is interesting. May I first begin with a cautionary note that it is not for me to comment on the sustainability of public finances and the Government's fiscal policy. However, if we stand back from that, I think you raise a very important point, because current borrowing costs are an important element of the sustainability of public debt because they influence the cost of financing it. The important relationship is that between the cost of borrowing and the growth rate in the economy. If the cost of borrowing—the rate of interest—is below the growth rate of the economy, it is fair to say that there is room for the Government to use that borrowing, and to feel more confident about the sustainability of their debt position.

I say that, because since the financial crisis—so in the last 12 years or so—we have seen persistently low interest rates, not just in this country but around the world. If you go back to the financial crisis in the period when central banks such as the Bank of England first cut interest rates to unprecedentedly low levels, there was an open debate about whether this was going to be a short-term cyclical phenomenon caused by the recession and the sheer severity of the financial crisis, or whether it was a more structural development in the world economy.

That was an open question. Increasingly, as time has gone by, it has come to be regarded as a structural phenomenon. The leading candidate explanations are the impact of an ageing population around the world and the effect that has on saving rates and spending rates; and, secondly, very low productivity rates since the financial crisis.

I say that, because it is important in thinking about the limits to the use of fiscal policy and in the context of monetary policy, which no doubt we will come on to. It goes to your point and in the direction of saying that there is scope to use public finances within that sort of framework. At that point, the balance for all countries is using public finances aggressively during the teeth of the crisis, which has certainly been true in this country, rightly so in my view, and having a view of what I call the longer-term sustainability, which is influenced by this question of the relationship between what we expect interest rates to be and growth rates. The growth rate is also impacted by this question of long-term productivity growth. We have had lower sustained growth rates over the last decade too, but still we have had very low interest rates.

The Chair: May I ask a supplementary on that? As far as I can see, since the beginning of the pandemic virtually all the new debt issued by the Government has been bought by the Bank. This pretty drastic tilt towards Bank of England-held debt means that the government debt interest bill is now inextricably linked to Bank base rate. Do you see that as in some way compromising the operational independence of the Bank, given that the Government have a very strong interest in keeping the base rate down?

Andrew Bailey: I do not. To put it in perspective, the base interest rate is not just influenced by the Bank of England rate, as Lord Tugendhat was saying; that, too, is influenced by what we tend to call its long-run equilibrium interest rate, which is very low, and is the underlying reason why our interest rates are so low.

To put the debt point in perspective, it is true to say that when we hit the teeth of the crisis in the middle of March, and we had to put the biggest ever quantitative easing asset purchase scheme in place, and we were purchasing government debt in the market. We do not buy it directly from the Government—that is really not in the acceptable manual—but we were buying in the market, it is true, at pretty much the same rate that the Government were issuing at.

By the way, that decision was not taken between the Bank and the Treasury, or the Chancellor and me. In the middle of March, we announced that we were going to buy at the fastest rate we could, because we were in the teeth of disorderly markets. We have since, however, eased down the quantitative easing programme in quite a big step back from that, so we are not currently buying at the rate the Government are issuing.

Lord Skidelsky: You said that the sustainability of public finances depended on the relationship between the cost of borrowing and the growth rate of the economy. You also mentioned the equilibrium rate of interest. If that has collapsed, where does that leave fiscal policy? If in fact the expectation of profit is very, very low, does that mean that there is no room for fiscal expansion?

Andrew Bailey: No, I do not think so. If we go back to the pre-Covid period for a moment—it seems like prehistory now—my view is that a sustained period of low equilibrium interest rates, certainly those that are below the growth rate, would indicate scope to use fiscal policy. I think I said this in at least one parliamentary hearing at another time, but it was scoped slightly to think in terms of the use of public investment, for instance. I think in general that remains the case. However, what has happened is that fiscal policy has had to be used, rightly in my view, very aggressively in the context of Covid, so the current starting position is very different.

Looking forward, the question of what scope there is to use fiscal policy is conditioned substantially by what has had to happen in the last seven months and what will happen going forward. The pre-Covid analysis is affected by that, but, looking forward, I do not take a strongly negative view on the use of fiscal policy, because I think we are in a different place for the foreseeable future—it might be for quite a long time—as regards this relationship between the equilibrium interest rates and potential growth.

Q3 **Lord Stern of Brentford:** Thank you very much, Governor, for joining us. Clearly a concern with stability, which is central to the Bank's mandate, involves anticipating the various risks that can come our way.

Andrew Bailey: Yes.

Lord Stern of Brentford: In public discussion of global risks, the risk of a pandemic has long been central to people's worries. In that context, do you think the Bank was sufficiently prepared for the outbreak of Covid-19?

Andrew Bailey: I have to say, and I have said it before on record, that I think the Bank and my colleagues have done a fantastic job over the last seven months. I am incredibly impressed by what the Bank has done. The best example of this came in the first week of my term. I always say that timing is everything, and I said to Mark Carney that timing is everything. I took over on 16 March; he really has impeccable timing. In that first week from 16 March, we had, as is well known, major disorder in financial markets by Wednesday, and by the end of the week we had no staff left in the Bank because we had all gone to remote working. So it was a good start.

The interesting thing, to give you an example, is that we had a very bad experience with financial markets in that week. We immediately had an emergency meeting of the MPC the next day, which, if I remember rightly, was the fourth ever, and by the following day, as I was saying earlier, we were implementing the largest asset purchase programme the Bank had ever done. I take my hat off to my colleagues for that. Like many institutions, I think we have adapted to remote working remarkably well.

As regards policy, yes, we have had to think through potential crises. I am sure we will come back to talking about the toolkit, as it were. As an institution, and I am sure many other institutions are in this place, if you had asked the Bank before Covid happened, "What happens if you have two weeks' notice of a pandemic?"—and it was not much more than that, probably a month—"and by the end of that you are almost entirely working remotely?", I suspect many people would have thrown their hands up and said, "I don't fancy that one". However, needs must, and I think we have adapted remarkably well.

Lord Stern of Brentford: That is saying that it was a very good team that reacted very quickly—indeed impressively. Had the Bank thought through this kind of risk, compared it with other sorts of risk and wondered about the special reactions to it, or was it just a good team that was hit by a crisis and reacted quickly?

Andrew Bailey: Certainly it is a good team. Of course I would say that, but I genuinely say that. One of the things that I reflect on with Covid, and it is true this week, is that it is a very fast-moving risk. In many ways, we are now into the third phase of it. The first phase was thinking about the economic implications of it. The first wave was pretty much universal with national lockdown restrictions. We moved into a phase where we were heading in the direction of having more differential sectoral impacts. It affects our policy in the general sense and affects fiscal policy more specifically, but it was sensible to think about more sectoral-specific measures.

Now, in the broadest sense, we have had to shift again, and we are now looking at more regional and local effects. We have all had to respond rapidly to understand the implications of that and what it can mean for the economy.

The Chair: I should declare an interest as chairman of Secure Trust Bank. Certainly my own experience with the PRA is that it has been remarkably flexible and fleet of foot in very difficult circumstances.

Andrew Bailey: Thank you.

Q4 **Lord Skidelsky:** Should more stringent conditions such as climate-related financial disclosures and limits on redundancies have been attached to the Covid Corporate Financing Facility? Are you thinking of extending that? If so, would you consider attaching some conditions to applications for that?

Andrew Bailey: First, I should make clear that in the corporate financing facility—the CCFF—the Bank acts as agent for the Treasury as regards the ultimate risk, and the decision-making within the CCFF reflects that. My view, and this was shared by the Treasury and the Chancellor, was that, given the emergency situation in which we put it into effect, and the job we wanted it to do as regards short-term and immediate liquidity provision to larger corporates, it was not appropriate to attach other conditions to the availability of it. By the way, there are credit policy-related conditions attached to it.

This is a very hard question and I have been asked it a lot. I should say that it is not because I am not a believer in the importance of directing investment and the economy towards climate-related solutions. Do not think that for a moment. The dilemma we faced at this point was that this was, frankly, about people’s jobs and livelihoods, and saying to companies and to their employees, “We’re not going to support your company because of its carbon footprint”, for instance, at that point of maximum crisis, was not a tenable proposition. So we did take that decision.

However, I am very keen that we move away from that towards our goals, which are to enable the financial sector and the provision of lending to support climate change. We want to get back to that position certainly as regards our intentions, but my view was that, given the size of the crisis we faced and the impact that it was going to have on people, it was not the right thing do at that point in time.

Lord Skidelsky: You would consider attaching such conditions to any extension of the scheme if there were to be an extension.

Andrew Bailey: Currently we are not looking at an extension to the scheme. However, if I can go to another piece of our landscape—the corporate bond purchase scheme—I said to the House of Commons Treasury Select Committee in my pre-appointment hearing that I wanted to address the question of the climate characteristics and profile of the portfolio of bonds the Bank holds. I want to get back to that issue, and, because that is a longer-term facility for the bank, I think that is the right place to focus.

Q5 **Lord Monks:** Prior to Covid, UK company debts had risen to record levels in 2019; I think that was after eight years of increases. As an aside, productivity figures are still very disappointing, so there is not a lot of evidence that this debt went into productive investments, which is very worrying. With regard to the new government schemes, including the CCFF that we have just been talking about, TheCityUK is saying that something like 40% of companies will find it difficult to repay their loans.

My question to you is: to what extent has the pandemic made corporate debt levels unsustainable? Are you expecting significant write-offs? Have you any idea what scale they might be?

Andrew Bailey: That is a very good question and there are several parts to that. You are right about corporate debt pre the pandemic, or at least in some parts of the corporate sector. The Bank of England’s Financial Policy Committee had been warning, interestingly, having spent almost a decade dealing with the consequences of high leverage in the banking system associated with the financial crisis, that we could see elements—not all of it by any means but elements—of the non-financial corporate sector that, to your point, we felt were too heavily indebted at that stage.

Frankly, Covid is the harsh lesson of the consequences of that, because there is no question but that the companies that went into the pandemic with much higher levels of indebtedness and leverage have found it much harder to deal with the consequences of the pandemic than those that did not. I am afraid there is a very salutary lesson to be had from that.

As regards meeting the corporate finance need going forward, I would make a couple of points on this. First, you are right in saying that it is absolutely essential and important that the Government have advanced an array of schemes to help companies with financing. These schemes are designed to tackle different parts of the market. We were involved directly in CCFF, which we have just talked about, which is the very big end of the market. I think that was absolutely the right thing to do. There is a lot of speculation, as you said, about the prospects for the creditworthiness of those schemes.

There are two questions underlying that when you look at the estimates of how it could pan out. The first is: what would be the fraud loss rate? Again, we do not know. It has to be understood that some of that lending, particularly in the smaller scheme—the Bounce Back Loan Scheme—was done very rapidly, necessarily so, as it was a matter of unblocking a pipeline and supporting some companies. We are not directly involved in this, but my own view is that it is important that the process of the payback of those loans and the uncovering of any fraud is done with great rigour. We cannot have a situation where there is a sense that you can take money off the Government in that way easily.

There is a second question, which is what we might call the economic losses that could result from companies that do not manage to get through the crisis. We have again had to deal with the fast-moving dimensions of Covid and the fact that we are now entering another phase of it, so it is very sensible that the Chancellor has extended the term of these schemes and enabled repayment to take place over a longer period. As regards dealing with the economic consequences of this debt, I have discussed it a number of times, and I strongly support it.

Finally, on your point, I come back to TheCityUK, which I talk a lot to. We talked at the outset, and still talk about, ensuring that where companies need equity capital going forward—this comes back to my point about not being overindebted before shocks such as Covid come along—we have a financial system, , that can support the provision of equity where it is needed, to put the corporate sector back on to a sustainable footing. That is very important, and the City, broadly defined, supports that. It requires some innovation in the provision of equity capital.

An encouraging factor is that companies, although not all companies, have been able to raise equity throughout this year, and quite strong equity-raising has gone on. That is good, but there is an understanding—I have discussed this with TheCityUK and it agrees—that one of the duties of the financial system is to ensure that provision of equity capital is available to companies so that we can have a sustainable corporate sector as a crucial element of the economy going forward.

Lord Monks: Do I take it from that that you see no danger of a credit crunch arising?

Andrew Bailey: I do not see that immediately. We have spent a lot of time at the Bank of England looking at this question. Obviously, the financing needs of the corporate sector this year are very large, given the situation it finds itself in and given the effects of the lockdown-type policies.

That is why it is appropriate that the Government have been an important part of the solution of that need, alongside active bank lending, active bond issuance and active equity issuance. We watch it very carefully. I cannot tell you that there will not be a problem, because, frankly, as I said before and as we are witnessing all around, Covid is moving quickly in ways we cannot always predict. As of today, the good news in all this is that we have had a severe health crisis and we have not had a banking and finance crisis to go with it. We have a banking system and a finance system that are supporting the economy rather than the other way round.

Lord Monks: Should the Government consider recapitalisation proposals? To cite TheCityUK again, it is pressing for a UK recovery corporation and a student loan-type system.

Andrew Bailey: No. I think it is much more important, as the Government have said, that we focus on two things. The first, as the Chancellor has done, is to focus on ensuring that the lending schemes are made sustainable, given what has happened. They were sustainable before what happened. The return of Covid obviously posed important questions, and the right thing to do was to respond with the terms of those schemes rather than consider some sort of slightly fancy, rinky-dinky repackaging of them. That is not the solution.

The second thing, to reiterate what I said, is to look forwards. We must look forward. We must look to the day when we are coming out of this and ask what we need so as to provide capital to companies that are sustainable. That is my point about equity capital.

The Chair: On the credit crunch point, looking back to the past, given the origins of the last financial crisis, is it sensible for Governments to start talking about guaranteeing 95% mortgage loans to people who would be considered subprime?

Andrew Bailey: What we are seeing in the mortgage market at the moment is quite a dichotomy. The best way of benchmarking this is to look at the amount by which we have cut the official rate this year and see what has happened to mortgage rates. Broadly speaking, at what I call the prime end of the market, mortgage rates have come down by a number that is more or less in line with the number that we have cut the official rate by. When you go up to the 90% LTV end of the market, you can see that the opposite has happened and that rates have increased.

Interestingly, to put that into perspective, that has actually reversed part of what was quite a steep fall in those rates in the last few years. We had had quite a sharp increase in competition in the mortgage market in the years leading up to Covid, and some of that at the 90% to 95% end of the market has been corrected. It has been corrected, because, as you say, there is considerable uncertainty about the future path of house prices. In one sense, that is an odd thing to say, because one of the strongest parts of the economy at the moment, if not the strongest part, is the housing market. Again, we know that the Government have taken action on that front with stamp duty in supporting the housing market, but it is reasonable that there is uncertainty about what will happen into the more medium term.

I am not surprised that we are seeing this dichotomy, to be honest, because of the uncertainty. The risk of extending high LTV loans, as house prices come down, is that we will be in the negative equity part of the market.

The question for the Government—and it is for the Government and not the Bank of England—is what is sensible support for first-time buyers. Interestingly, the activity numbers in the market do not necessarily suggest that there has been a decline in the proportion of first-time buyers. It is unsurprising, and I would not criticise lending institutions for the fact that they have become more cautious about 95% LTV mortgages in the current environment.

Viscount Chandos: Another aspect of the stability of the banking system is that, while clearly the banks' risk of loss is limited on bounce-back loans and CBILS, the burden on their management in both advancing those loans and managing them is very significant, at a time when their exposures to the same companies, or to other companies, and to other sectors, is likely to be extremely problematic. How do you feel about the capacity of the banks to cope with that strain?

Andrew Bailey: That is a very important question, and I say this with quite a lot of feeling because I bear the scars of my former time at the Financial Conduct Authority in seeking to try to resolve the problems on that front that came out of the financial crisis. I have said a number of times, and I would emphasise this, that it is critical that there is very clear understanding of how that process of dealing with the loans, particularly those that turned out to be not serviced or difficult to service, and dealing with customers and companies that get into debt problems, is handled, because the record of this country in the past, as we know, has not been good.

I do not think it is a case of saying that there is blatant illegality by people at the head of banks. What I think has happened over the years, as you have said, is that it tends to be a very cyclical phenomenon—unsurprisingly so. The volume of different loans that have to be worked out rises in difficult economic conditions just at the point when, as you say, the banks are finding themselves most stretched in managing their resources and loans.

It is vital that there is a very clear understanding, in this case, between banks and borrowers—it involves the Government as well because of the government guarantees—on how that process is going to work. I am not involved in that process, but I know that those conversations are under way, because before we get to the point of repayment, and before we get, sadly, to the companies that will get into difficulties, we need to be clear about the rules of engagement.

Q6 **Lord Livingston of Parkhead:** Governor, this is clearly a very different type of recession from ones we have seen before. Do you have a view about the likely level of scarring in this recession compared to the early 1980s or the financial crisis in 2008? Do you see it being substantially more or different? Is enough being done to prevent it?

Andrew Bailey: I have to be honest with you that it is very hard at the moment to put an estimate on how much scarring there will be. We have had to have a go at that in our quarterly forecasts, but we are very honest about the fact that there is huge uncertainty about this. I can give you a sense of that in the forecast that we did in August. We tend to have a proxy measure of scarring by saying, "At a point in, say, a year or two's time, to what extent does it look as though, over the longer term, economic activity will be lower than it would have been in the forecast we made before Covid?", and that is a decent measure of scarring. We had a number that was, about give or take, 1.5% of GDP. That is at the low end of other people's estimates, I would say, so the risks are all on the side of it increasing.

Of course, as Covid returns, and if the prospect is that it will go on for longer, then there are two reasons why the prospect of scarring can increase. One is because there are more companies and employers who cannot survive through the effects, as it were. Secondly, as I mentioned earlier, there are activities that may turn out not to be ones that we demand and we change our habits in ways that create a need for people to relocate in the labour market and to learn new skills.

Again, the Chancellor and I discuss this a lot. I think it was very important in terms of thinking about the focus of the use of government policy that issues such as retraining and enabling job searches to happen more effectively come to the fore as we get through Covid. Understandably, and unfortunately, of course, we are now going back into Covid, and so, in a sense, that mixture of policies has to be rebalanced, again perfectly sensibly, but it is important that we have that in mind, because what we know from history, to go back to your question, is that one of the most damaging things that we can have in the economy is this long-term scarring and the fact that people become detached from the labour market for long periods.

Lord Livingston of Parkhead: Would long-term joblessness be what you are looking at as a key measure? Is there any reaction you can have to it as a bank?

Andrew Bailey: The persistence of unemployment is the key measure in this. It is key for two reasons. One is because it is a good overall measure of it, but, secondly, and more importantly, because it is a critical measure of what we do not want for the welfare of the people in the country. Obviously, we can use our policy tools, and we do use them. It is clear that employment and activity in the economy are critical to our policy tools, but it needs more than our policy tools when you are talking about enabling people to retrain and to search for jobs more efficiently. All those tools are not our tools, so we need to operate tools in combination, as it were, to get the best effect there.

The Chair: That brings us very neatly into Baroness Kingsmill's questions.

Q7 **Baroness Kingsmill:** You have said that long-term changes in the UK's economy and labour market are unavoidable and that you cannot stand in the way of this. I want to get to the nitty-gritty of this a little by hearing from you what makes a job viable. Are you able to judge at this stage what the viable jobs will be in the future? How do economists tend to make these judgments?

There is a third element to that. How do you avoid social distress with people who have trained for many years as X who now find that that sector is unviable and they have to retrain? There are a lot of human issues in that as well, but could you give us some idea of what you believe to be the viable jobs or sectors and what would be the test?

Andrew Bailey: In a way, of course, we are not the best judges of what is and is not viable. That is done at the level of employers and employees. We are already seeing this happening in many ways. I would give you two examples. The share of online retail sales rose from around 20% to 30% during the first few months of the lockdown. That is a 10% increase. The interesting thing is that, I think I am right in saying, the previous 10% increase—that is, from 10% to 20%—took about seven years, so we saw in about seven weeks a rate of structural change in the mix of retail sales that had previously happened over seven years. Whether there will be some reversion is an interesting question, but that is a very substantial change.

Another interesting thing that our regional agents pick up is that there is some evidence, they think, of some acceleration of investment in automation as a result of Covid. Obviously, what they can and cannot do is fairly restricted at the moment, but where companies can invest in automation it helps them from the point of view of things like social distancing.

This is very speculative; I will be honest with you. We talked earlier about weak productivity since the financial crisis and said that there are several candidate explanations for that, but I speculate occasionally as to whether Covid will be a shock that may begin to address some of that question, in the sense that it could cause some greater dislocation of employment, with people then choosing—

Baroness Kingsmill: It certainly speeds change up a little.

Andrew Bailey: Yes. That goes to the question and increases the importance of the need to ensure that people can move jobs, retrain, get new skills, get skills to match the direction in which the change is happening. I think that is right. I cannot prove to you in any sense that there will be a longer-term effect on productivity. At the moment, the productivity numbers are going the other way, if anything, because they are affected by the negative policies of social distancing and so on, which are essential but not good for productivity. It is interesting that we have a few what I might call at least initial signs of things going the other way.

Baroness Kingsmill: What tools can the Bank use to either facilitate or influence the direction of this restructuring?

Andrew Bailey: It will have an effect on monetary policy for the reason we discussed earlier on, which is that it will have an effect on the long-run equilibrium interest rates. One thing that has done is forced us to be very active in considering what tools we have in our monetary policy toolkit. First and foremost among them has been the extent to which we use quantitative easing, how quantitative easing works—we will come on to that—and in what conditions it may be more effective than at other times. As is well known, because I have to answer these questions almost every day, it has forced us to address whether we need to consider negative interest rates in the toolbox.

The Chair: We have some questions on that.

Q8 **Baroness Bowles of Berkhamsted:** I am coming in out of order because we have already strayed into the subject. Should the Bank take unemployment as seriously as inflation and get it formalised as an operational target? You have already said that it is a critical measure, so why not be like the Fed and have it formalised?

Andrew Bailey: Currently, our objective is to meet the inflation target and in a way that helps to sustain growth and employment. Sustaining growth and employment goes with meeting the inflation target in that sense. May I put this into a bit of recent context, and this will get us to the question of what other central banks are doing as well?

The MPC has been in existence now for over 23 years. The first decade of the MPC's existence was remarkably benign in many ways, until the financial crisis, with very few large shocks. Inflation stayed quite well behaved around the target. I am sure that the policy-makers at the time, as I was involved in this, did not always see it that way, but, looked at through the lens of what has happened subsequently, it looks pretty benign. Unfortunately since then, over the last 13 years or so it has been anything but benign. We have had much bigger shocks; the financial crisis was the first one, and now Covid has come along.

I give this history, because the consequence, unsurprisingly, in the last decade is that all central banks have had to look at how they adopt a more flexible form of inflation targeting. We are all trying to get the best combination of the nominal anchor that comes with an inflation target, and flexibility around that nominal anchor to support the objectives of sustaining growth and employment.

During Mark Carney’s time, the Bank, working with the Government, adopted a number of changes to the way in which the regime operates, in our case to allow us greater discretion over the period in which we return inflation to target and particularly—this is very important—where there is a trade-off between activity in inflation and activity in employment. That is where we are today.

I would stress the forward guidance that we adopted in August and that is in place today, which says that we do not intend to tighten that policy until there is clear evidence of significant progress in eliminating spare capacity and achieving the inflation target sustainably. That means, in other words, that we are prepared to wait. Because of the huge uncertainty at the moment and because of the importance of growth and employment, we are prepared to take longer to see that there is sustained and significant progress in getting the economy back on its feet and normal again.

Let me come to the Fed. There is more than one way to incorporate flexibility into the target. The Fed operates under an old and dual mandate, as you said, which puts inflation and activity in employment on a dual footing. A decade or so ago, it adopted an inflation target as a means of representing that. It adopted it itself, because there was a different statutory structure to it.

What the Fed has done in the last two months is to move further towards a form of what it calls averaging. One way of adopting flexibility is to have a certain amount of averaging of inflation so that, in a sense, you can move the shocks out, and again you have more choice over how fast you move because you have the smoothing effect of an averaging of the inflation target.

I tend to look at this and say that we are all broadly trying to do the same thing, which is to ensure that we get enough flexibility but do not sacrifice the benefits of the nominal anchor of the target. I would definitely put that into the context of the guidance that we have adopted. We have widely adopted this guidance to say that it is appropriate in the current environment, in our view, with the uncertainty we face and the risks we face, that we appropriately position policies so that we can be more confident that we are sustaining growth and employment if we appear in the forecast to be heading back towards the inflation target.

Baroness Bowles of Berkhamsted: Does this mean that lower interest rates are the new normal, and perhaps if you go back centuries it was normal then? Therefore, we are moving out of a period of inflation at 2%, and we might have to have an averaging effect or a delay effect so that there is a new normal that is below 2%, especially if the conditions are not around that affect the demand side, because that is being determined by other things?

Andrew Bailey: I have a couple of thoughts on that. Interestingly, if you look at the history of UK inflation and the consumer price index for the period since the end of the financial crisis—so we are talking about spring 2009—I think I am right in saying that average inflation between then and now is very slightly over target, but not much. It is very near to target.

That is a bit different in other countries. In other countries it has tended to be more; there is a gap under target. There may be a number of reasons for that. One—and this is a difference when comparing the UK and the US—is that we are a much more open economy and the exchange rate has much more of an impact on the pass-through to inflation. There is that quite interesting difference.

The important point you make, and here again I go back to the history and the earlier days, is that certainly when we adopted the inflation target—I remember it; I was working here—everybody viewed inflation targeting as a device to get inflation down to target. The fact of the matter is that we have all spent the past decade trying to work out how to get inflation up to target, and we are still very much engaged in that. So you are right that, in that sense, it is a different landscape.

Lord Stern of Brentford: You have indicated very understandably that the concern with unemployment is likely to be of special intensity in this coming period.

Andrew Bailey: Yes.

Lord Stern of Brentford: But this is a shock that is not simply an aggregate shock; it is a sectoral shock and a geographically differentiated shock. How would those considerations come into the Bank of England's policy?

Andrew Bailey: They do. Let me say first that one thing we have spent a lot of time trying to discern is the extent to which it is a demand shock and the extent to which it is a supply shock, because we know that those have different effects. There is that question to start with. Like all central banks, we have to hold our hand up and say that there is still a lot of uncertainty about that judgment.

You are right, and this is the interesting thing that we talked about earlier. If you had asked me this question a couple of months ago, the focus would have been on the sectoral side for the reason I may have mentioned earlier, which is that, notwithstanding the relatively rapid recovery over the summer, it was sectorally very uneven, for reasons that are perfectly understandable stories, as it were. We still have that, by the way, but we now have a regional story emerging as well.

This is why our agents are so important to us. We have to take all that into consideration, not because we can target that policy at regions, but because, in understanding the forecast of what will happen, that will have an increasingly important bearing particularly on the short-term pattern of the forecast.

Q9 **Viscount Chandos:** In August, you backed the decision to close the furlough scheme, and in September you called for the Government to stop and rethink the end of furlough. I guess the facts are changing pretty quickly, so that pivot is understandable, but how much does the Winter Economy Plan which the Chancellor has announced reflect what you were calling for?

Andrew Bailey: May I start by playing down this idea that I changed my mind on the question about the furlough scheme, because I did not. What I said back in August—and, by the way, the detail of this is for the Chancellor—was that, in my view, from a macro level of detail, the real question was about the right way to provide support going forward.

I think the furlough scheme was a very good policy and was the right answer to the first period of Covid, which was having widespread effects when we had a widespread lockdown. The furlough scheme was exactly the right answer to that. As we came through the summer, and as the number of people using the furlough scheme was coming down and the furlough scheme was evidently becoming more sectorally concentrated in its usage—no surprise there—it seemed to me right to ask, "What will the next thing be? It doesn't look like the furlough scheme, which has been the right thing to do".

Of course, what the Chancellor has had to do—again, I think this is exactly the right way—is to say that now we are going into the third phase, where we have elements of a sectoral issue and emerging regional differentiations, although not a national lockdown. I defer to Lord Skidelsky on this, but I will borrow the well-known phrase from Keynes that, "When the facts change, I change my mind". The fact of the matter is that the most striking feature of Covid for an economic policy-maker is just how fast this thing changes.

Viscount Chandos: Looking at what is now on the table in the Winter Economy Plan, and even since its announcement with the three tiers of regional grading and so on, do you feel that the Job Support Scheme on the one hand and the level of subsidy at two-thirds of salaries for locked-down companies' employees on the other are creating the stability and the environment for reasonable economic resilience?

Andrew Bailey: If you do not mind, I defer to the Chancellor as to the appropriateness of the policies at that level.

Going back to the point I was making, I think it is entirely correct and appropriate that, fortunately, as the nature, incidence and pattern of Covid change, the policy response changes to match it. That is what we see, and I strongly support that. We have to use all our policy tools in the current extreme environment to the best extent possible, and that means changing. I reject people who say that that is inconsistent. It is not inconsistent. The fact of the matter is that we are dealing with a shock, and it is a pandemic that changes at an extraordinarily fast pace.

The Chair: You have not tempted Lord Skidelsky.

Q10 **Lord Burns:** Governor, it is very good to see you here in your new role.

Andrew Bailey: Thank you.

Lord Burns: I would like to move to the possibility of negative interest rates. You have said that negative interest rates are in the toolbox of measures that could be used but that they would be contingent on economic circumstances. You also say that you do not expect those circumstances to arrive very soon. Can you say any more about what those conditions would have to be to persuade you to move in this direction?

Andrew Bailey: I am happy to do that. For us, there are three dimensions to the issue of negative interest rates. The first is the question we tried to answer over the summer, which was to look at the policy as a tool and to ask how appropriate it would be in the UK, bearing in mind that it has been used in the euro area for a number of years, and in Sweden, Denmark and Japan.

We looked at the evidence from those economies to see, first, what their experience was with it and, secondly, what the particular issues were that it gives rise to, and how those would, in a sense, fit in to the UK.

We came away with the view that, at the very basic level, negative interest rates operate in much the same way as any other movement in interest rates, in the sense that they have worked through financial asset prices and they have worked through exchange rates.

The second leg is the question of the transmission mechanism. This is where the differences occur, and they are important differences. We saw this in other countries. Probably the critical bit of the transmission mechanism is that retail saving rates in other countries have not been put negative. Negative rates have been used at what I might call the big end in big corporate financial services, the wholesale end of the market.

In some cases, that has been deliberately structured into the policy by using a tiering approach. It means that the transmission mechanism affects the rates, because the larger the share of retail deposits in the banking system, the weaker the transmission of negative rates, if you adopt this condition of not using them on retail rates. The UK these days has a high share of retail deposits in its deposit base, and, as you know, we have reinforced it with a ring-fencing structure. That is an important conditioning factor.

The second aspect, which gets to your point, is that the lesson from the work published by the European Central Bank is that it implemented negative rates in the recovery phase from the euro area crisis. Its research work suggests that it worked in two ways: one, by doing it at that point in the cycle where the negative effects, particularly on the Bank's net interest margins, were offset by the fact that, in the recovery phase, lenders' provisions were being released, which cushioned the impact on the banking sector; and, secondly, by focusing on what I might call higher-end deposits, where it acted as an inducement to investment. If a corporate has a choice between a negative interest rate on a deposit and investing that deposit in productive capacity, the ECB's evidence would be that there was evidence that it supported investment.

That will tell you two things. First, it will tell you about the importance of the financial system and banking system as an indicator of the transmission mechanism, and, secondly, it will tell you something about the point in the cycle where this seemed to work more effectively than at other points.

The second piece of work that we are doing now, and we put out a letter to the banks yesterday, is addressing what I call the nuts and bolts of it. The cardinal sin on our part would be to say that there was something in the toolbox that we did not know could work. As you will know, the big question is: do banks' systems allow them to put in negative numbers? I would also ask the same question if we went to zero. It is well known that if you try to divide a number by zero you do not get a good answer, so there are a lot of very important questions that we have to address there.

It is only when we get through these phases that we will be in a position to ask whether it is a tool that we would use in any given position. We make policy meeting by meeting, so we would have to answer that question. We are not there at the moment. I say that, because there is an awful lot of speculation, and everything I and my colleagues say about negative rates is assumed to be a judgment on whether we will use them next month. I am afraid that it is not at all. At the moment, it is a judgment about the appropriateness of them in the box of tools.

The other reason why we have to have these sorts of considerations is because one thing we have learned from Covid is that we have to look at what is in the toolbox. What was considered to be in the toolbox before Covid came along does not look very good by comparison with what we have had to do.

Lord Burns: Indeed. I notice that some of your colleagues have said that negative rates on retail deposits could be counterproductive because of the impact on bank profits, and you are indicating that yourself. Am I to take this as an indication, therefore, that you would not look to use this in the sorts of circumstances that we have now, but you are emphasising that it could play some role during the recovery phase?

Andrew Bailey: I would go back to sitting around the Monetary Policy Committee table—you have done this in the past—where the discussions have been, first, about how this tool would work, and, secondly, about the operational issues about putting it into effect. There has been no discussion of the sort, "What if we did it this month?" We are not there at the moment.

The Chair: Am I just getting old and cynical, because I thought you might be trying to send a message to the big banks that they should not be sitting on money that they should be lending to get the economy moving again? Is that too cynical a view?

Andrew Bailey: Very much as I was saying to Lord Burns, the ECB's evidence—it is not so much the banks as the depositors, in a way—suggests that the upswing from the euro area crisis has had some beneficial effect on investment, which would go to your point about lending.

Q11 **Lord Tugendhat:** My question is a little related to the last one I asked and it concerns quantitative easing. Do you think quantitative easing is likely to become a permanent feature of monetary policy? Is there any upper limit to the expansion in quantitative easing?

Andrew Bailey: That is another very good question. First, going back to the point we discussed earlier, in a world of very low equilibrium interest rates, where our policy rate is as near to zero as it almost can be, there is a much more important role for quantitative easing as an alternative policy. That is not just true in this country but has been true in other countries. There is a huge debate about just how quantitative easing works. Ben Bernanke famously once said that it works in practice but not in theory. It is interesting that, even over a decade on, there is still a lot of debate about it.

I set some of these thoughts out in remarks I made about six weeks ago at the virtual Jackson Hole conference. We published quite a long paper on it. There is some evidence to suggest that some element of the QE effect is contingent on the state of the economy and the state of markets. When we used the very aggressive QE in March, we were trying to tackle the two things that were coming at the same time. One was a very major disruption to financial markets—not the banking system, which was okay. The other, obviously, was a major downturn in the economy.

We had to use QE as a means to get liquidity into parts of the financial system that we would have found it harder to get into using conventional means of lending through the banks. That QE seems to have been more effective because it very quickly stabilised financial markets. In normal times you are not trying to do that. You are trying to have a more direct economic effect. There are good reasons to think that QE has direct economic effects, but it is true in normal times that not all the effects will operate as powerfully as they probably do in disorderly times. QE is somewhat state contingent in that sense. Because of the prospect of continuing low interest rates, I think QE will remain part of the active toolkit for quite some time to come.

The second question we have to ask ourselves is not just what the limit of QE is but what a sustainable policy towards QE will be. What I am about to say is not for now, because it is all about looking to a day when we are into a period of sustained recovery and what the right approach to the stock of QE is then. Our balance sheet has grown very rapidly, although I will not say that I am tremendously proud as governor to have grown our balance sheet as much as I have in my first six months. Our policy tools are, effectively, countercyclical. We use policy aggressively in the downturns, particularly QE policy.

The question I posed in the Jackson Hole remarks is: what is the right approach to QE going forwards, particularly when the economy starts to recover? It is the case in this country, but not quite so true in the US, that if you look back to the financial crisis and then forwards, the stock of Bank of England QE did not fall during that period. If we went on doing that—sadly, we expected some shocks to the economy from time to time, and we have had two in the last 12 years—that poses questions about the Bank of England balance sheet. It is not a solvency question in that sense. It is a question of what a sensible structure and scale of the Bank of England balance sheet are. It is much bigger today, frankly, than it was when I joined the Bank of England, and our predecessors would have known. There is a case for seeking to manage the stock of QE down during upturns in the economy, but, just to reiterate, we are nowhere near that point at the moment.

Lord Tugendhat: May I ask one follow-up related to the question? What progress has the Bank made in decarbonising corporate bond purchases?

Andrew Bailey: That goes back to something I mentioned earlier. We have a corporate bond purchase programme. It is a relatively small part of the QE stock, but it is important none the less. Again, back in the pre-Covid age, both Mark Carney and I were keen to move towards adopting some form of climate-related benchmark for the corporate bonds we hold—with the Treasury, because the Treasury ultimately bears the risk on it, or the Government do.

Currently, the corporate bond portfolio is a representative cross-section of the sterling corporate bond market. We deliberately do not take any view on what we buy. We are not in the position of picking winners. We are aiming to find a suitably neutral but climate-directed benchmark—a neutral benchmark that takes climate into the consideration. We have not been able to pursue that work over the last six months, I am afraid, partly because of the need, as I said earlier, to support the economy and partly because of the demands on our time, but I am very keen that we get back to that question as soon as we can, and we will do.

Lord Skidelsky: I want to follow up on the discussion on the effectiveness of QE and monetary policy in general. It is of a cycle. It has often been said that monetary policy is effective at cutting off a boom or dealing with inflation, but much less effective in generating a recovery. In other words, you can shove up interest rates as much as you can and that will have an effect on the boom, but lowering them as much as you can will not have very much effect on getting the economy to recover. The conclusion drawn from this line of analysis is that fiscal policy is much more effective than monetary policy in generating a recovery from a low point in the cycle, which has not been the general view up to now. The view has been that monetary policy has operated more or less symmetrically in the different phases. I would be interested in your view, Governor.

Andrew Bailey: The first point to make is that they operate together. By the way, I think it has been very important over the last six months that we have operated them in close co-ordination. That does not jeopardise our independence at all. As we were saying earlier, what we can do through monetary policy is provide, as you say, the underlying support to aggregate demand, both through the cost of borrowing, and, in a QE world, through buying less liquid assets and substituting them with more liquid assets in the economy that are more readily able to be spent, that is bank reserves. That is what we do.

As we were discussing earlier, at the moment there is a clear role for using fiscal policy, as the Government are, to support not only the country as a whole in areas at issue such as the lockdown, but, as we were discussing in the context of structural issues in the labour market, as the Chancellor has done in the whole question of job support schemes.

I think this question about whether monetary policy is out of fire power can be overstated. We are not out of fire power at all. What this has called for is a very close and sensible co-ordination of the two to get the benefits of both.

Lord Livingston of Parkhead: Back to QE, I listened carefully to your answer, Governor. QE has always been described as temporary. I am mindful that income tax was supposed to be temporary 200 years ago. At what point does temporary become permanent? It was meant to be QE followed by a period of quantitative tightening.

Given particularly what we are looking at—I am thinking of Japan, for example, and what has happened there over decades now—are we now in a situation where the stock of assets that you purchased under QE is pretty permanent; and the notion of reversing that whole stock does not exist and we are just talking about the rate at which you add to it—that things have actually changed? I thought your answer seemed to be slightly different from that which I have heard from governors before regarding QE.

Andrew Bailey: There are a number of strands to the answer to this question. The first one goes back to something we were saying earlier. If we had had this conversation 10 years ago, when interest rates had fallen to unprecedentedly low levels, but there was a genuine issue about whether that was a cyclical phenomenon coming out of the financial crisis and the recession that that induced, or whether it was a longer-term structural phenomenon, I think it was perfectly reasonable at the time for people to think that it was more likely to be cyclical than structural.

That is the situation that lies behind the point you rightly made earlier, which is that people tended to think that QE would be a temporary policy, because if the cycle reverts to normal, the relevance of QE, given that interest rates will always be a further marginal tool, will fall away and it will be short-lived, as you say. What we found, of course, is that the structural argument appears to have prevailed, so we are in a world of long-term structurally low interest rates for what we can see going forward. I would never say that it will not change, because it will at some point, but not as far as we can see at the moment.

Therefore, that changes the attitude towards the permanence of QE as a policy tool, because if we are going to be in a world where interest rates are near zero for a prolonged period, we will be using QE more, and it will be with us more. In a sense, this goes back to my point at Jackson Hole: we have to consider the appropriate use of QE over time in managing the stock.

Lord Livingston of Parkhead: Presumably, it also has an impact on the overall level of government debt that it can sustain if you are sitting on a large proportion of it.

Andrew Bailey: No, I would be rather careful about that, because it does not mean that we are financing the Government on the cheap at all. I come back to the point I made earlier that we only buy in the secondary market, so the Government have to face the market when they sell debt. They do not face us. That is important. It is often called fiscal dominance. The form that people sometimes write about is the pernicious form, where fiscal dominance is involved, and there is no fiscal dominance involved in this situation.

Lord Livingston of Parkhead: Well avoided. Thank you.

The Chair: Are you concerned that at least some people in quite high places seem to have got the idea that, because interest rates are very low, large amounts of public expenditure can be committed on projects that are not capital projects?

Andrew Bailey: Again, that is for the Government and not for me, but I come back to the point about the economic impact of sustained low interest rates, particularly if the low interest rate is below the growth rate, because that would suggest that there is scope for sustainable public investment, but you are right that it has to be in projects that earn a rate of return. History is quite mixed on that front. Let me put it that way.

The Chair: Quite.

Q12 **Lord Stern of Brentford:** At times of crisis, you expect the great institutions of the state to come together in as coherent a way as possible. It is clear from your earlier descriptions that this has happened with the Bank and the Treasury. You also emphasised that in this particular period the concerns about growth, employment and stability loom still larger for the Bank. In your view, does this herald a period where you see still closer co-ordination with the Government, and between monetary and fiscal policy?

Andrew Bailey: Let me make the point again. I do not think that any of this is, in any sense, sacrificing our independence, but you are right: in conditions particularly like this, it is important that policies are co-ordinated and, frankly, we are using all the tools to maximum effect. In the Covid crisis—again, history has an important lesson for us in this respect—it is important to use policy actively and aggressively, in my view. That is learned from difficult experiences in the past. I believe that is what we have done. That involves co-ordination, and we have done it. My answer broadly is yes, we will do it, and it is appropriate to do it in that sense.

Lord Stern of Brentford: I would not suggest for a moment that co-ordination means loss of independence.

Andrew Bailey: No, I was not suggesting that you were.

Lord Stern of Brentford: You have to be independent to choose to use it.

Andrew Bailey: That is true. You do.

Lord Stern of Brentford: Taking that argument a little further forward, focusing on growth, stability and unemployment, the Government have an agenda, which is very understandable, on levelling up, infrastructure, net zero by 2050 and productivity. It is probably fair to say that those in particular characterise the Government's view on growth, stability and employment. Would you see the Bank of England building those in- in a systematic way—you have already remarked on climate and net zero—on levelling up and infrastructure?

Andrew Bailey: It is important that if we have an economy that is in a position to support investment in that sense—again, this is not for the Bank of England; it is for the Government—it is used towards the right public policy goals. I support the Government in this respect. Climate and levelling up are important things. If we have the opportunity to use public investment constructively, that is a very sensible thing to do. We are part of the overall policy-making arena, but it is not the Bank of England doing that per se. What we have been able to do is support the analysis that leads to a view on the capability to use that situation, particularly with equilibrium interest rates.

Lord Stern of Brentford: Thank you.

Q13 **Lord Skidelsky:** What is the Bank doing to prepare for the possibility of there being no trade deal in place at the end of the transition period? I suppose there is a prior question, which is: what impact does the Bank expect from one or other of those scenarios? Following on from that, what would the correct monetary response be to either a no-deal scenario or a deal?

Andrew Bailey: Our forecasts are conditioned on government policy in terms of the central case of the forecast, and we consider the risks of that. Our forecast in August was conditioned on a CETA-style trade agreement. For the risks to our forecast, which were very substantial but dominated mainly by Covid, we used a basic WTO outcome as a way to calibrate the risks. We are about to have to come back to this for the next forecast in early November, by the way.

There are two parts to it. The first is that we have this convention of conditioning on government policy. The second issue that we will have to consider is what one might call the degree of disruption that goes with any of these outcomes, and how we build that into both the central case and the risks. We will have to spend quite a bit of time considering that in the run-up to the early November forecast.

I have to say that it is complicated at the moment by the fact that there is the potential for no trade agreement, which could mean negative trade, but Covid, too, could mean negative trade because of the effect of the restrictions in the economy. That complicates things in the sense that we will also have to unpick which of those two things is contributing. That is a task that faces us over the coming weeks. We shall reach a view on it. I would finish by saying, as I say regularly, that for all parties involved in this process a trade agreement is the best outcome.

Lord Skidelsky: Given the uncertainty and complexity of these possible outcomes, are any projections worth the paper they are written on? I know you have to say what you are going to do, but how can you base policy on matters that are so uncertain?

Andrew Bailey: First, and I know that Mervyn King used to make this point a lot, we have to be very conscious of the level of uncertainty and the impact that it has. Interestingly, we calibrated uncertainty in our August forecast. We have been doing this for nearly a quarter of a century now, and I think we calibrated the level of uncertainty in our August forecast as being one and a half times the previous highest ever level of uncertainty. We use a variety of imprecise measures and approaches to try to calibrate it.

Secondly, we produce a fan chart, and the risk on that fan chart had one of the biggest negative skews, if not the biggest negative skew, that we have ever had on a distribution. I emphasise the fan chart, because, again, the central case is obviously subject to huge uncertainty. We use the fan chart and the uncertainty measure to try, in a sense, to represent the overall situation that we are in, notwithstanding the fact that they are all highly uncertain, too.

There are two big messages that come out of that. One is the highest level of uncertainty ever, and the second is a very big negative skew. We then have to feed those things through into the policy position, not in a mechanical way—we cannot do it in a mechanical way—but in a way that takes them on board, and in a way it is represented in the forward guidance that we are using which I mentioned earlier. That forward guidance, and the caution that we have towards what I call the central case, and therefore how policy will respond to that, is conditioned by the uncertainty and the negative risks.

Q14 **Viscount Chandos:** May I revert to the banking system? When Mark Carney came for his farewell gig, I think in February, we discussed the resilience of the banking system to a downturn in growth in China, because at that point that seemed to be what Covid's impact was. We are now facing something massively greater on a global scale, and, as you said in answer to the Chair's first question, if it is a V it is a very lopsided V. How confident are you that the banks, with all the strengthening that has happened since the financial crisis, are none the less in a good position to weather a period of very slow recovery?

Andrew Bailey: Since March, we have run two series of tests of the resilience of the UK banks. In May, when we were even more uncertain about where we were, we used a scenario for the economy. In August, we used what we call a reverse stress test, which is how much stress one can take. We conditioned that reverse stress test in broad simple terms by doubling the amount of stress that we already had, which was huge in its own right. We found that, even if we doubled it, the banks still had buffers of capital on which they could depend and fall back on. It is also important because, going back to the point I made earlier about the banks supporting the economy and not the other way round, it means that there is capacity in the banking system to use its buffers of capital to continue to lend, which is very important.

Honestly, touching wood wildly at this point, at the moment we are in a very different place with the banking system. I will be honest with you; the reforms that were put in as a result of the global financial crisis are now being put to the test more than they have been in the previous 10 years. I think it is paying off. The banks are resilient. They are in a much better place to support lending and activity in the economy, and that is a good thing.

Obviously, we have to constantly update these tests and keep running them to reflect what is happening, because it is not just the scale of the downturn but the persistence of the downturn that will have an impact there. I can tell you that, so far, the story on that front is encouraging and supportive.

Viscount Chandos: And not just the persistence but presumably to some extent the sectoral distribution of pain.

Andrew Bailey: Sectoral in the sense of the—

Viscount Chandos: The industries that are either growing slowly or declining, and the exposure of the banks to them.

Andrew Bailey: Yes. Our stress tests take that into consideration.

Q15 **Lord Monks:** What is your view, Governor, of the title of the Bank? Is the title "Bank of England" not something of an anachronism at the present time, with the development of the four nations, and so on, and pressure for another Scottish referendum? Is it not time to call it the Bank of the United Kingdom?

Andrew Bailey: My predecessors have been asked this question a number of times in the past, and I think we try to strike a delicate balance here. We put a lot of effort and attention into being the central bank of the United Kingdom. That is a very fair point. We have our regional agencies. I have to be honest with you; one of the saddest things about my first six or seven months is that I have not been able to get out around the country in the way I did. I have been doing virtual regional visits. Last week, I spent a day in Yorkshire without leaving the office. I was online to various events organised in Yorkshire. I did one in Northern Ireland a couple of weeks ago. I cannot wait for the day when we can get out there for real again, but I do not think it would be the right thing to do at the moment.

We put a huge amount of effort into that. It is about the balance of history and of reputation. It is a name that has a lot of standing, frankly, not just in this country but globally, and I would be reluctant to give that up. In a sense, we have to look through the name. I am very conscious, as my predecessors have been, that we have to do all that we can to make sure that we are not just in touch with but are acting on behalf of the whole country. I take that very seriously.

The Chair: Of course, the Bank of England was founded by a Scot, Sir William Paterson. I have to say that he went on to found the Darien scheme, with not a lot of success.

We have kept you for more than an hour and a half now. Perhaps I could finish with one quick question. Your predecessor, Mark Carney, encouraged this Committee to do a report on measuring inflation. We have produced a report, which was very well received, although perhaps not as well received in the Treasury. How much progress have we made on this?

Andrew Bailey: This is the whole RPI question.

The Chair: The RPI, the CPI and all that.

Andrew Bailey: I keep hearing that there may be some progress towards resolving when it will be changed over, but I think Covid has got in the way of that. In a way, it is a question for the Treasury, but if you like I can certainly see whether we can write in and let you know where we think things stand.

The Chair: Although I say it myself, it is a pretty good report and it is worth a read.

Andrew Bailey: It is an important question, yes.

The Chair: Certainly lots of wet towels were put on the heads of the Committee in producing it, I can assure you.

Andrew Bailey: By the way, as I am sure you say—I have not seen the report—it is important for areas such as the pension industry.

The Chair: We thank you, Governor. You have answered no fewer than 15 questions and you have given us straight and very concise answers, for which we are very grateful. We realise that there are many pressures on your time at the moment.

Andrew Bailey: Not at all. It is very important to me.

The Chair: We are very grateful to you for coming to the Committee and we look forward to seeing you again in the future, when hopefully we will have the worst of this crisis behind us.

Andrew Bailey: Let us hope so. Thank you very much.

The Chair: That concludes this session of the Committee. Thank you, everyone.