



Treasury Committee

Oral evidence: [Appointment of Deputy Governor of the Bank of England](#), HC 205

Wednesday 11 June 2014

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Members present: Mr Andrew Tyrie (Chair); Steve Baker, Mark Garnier, Jesse Norman, Teresa Pearce, Mr David Ruffley

Questions 1-110.

Witness: **Dr Ben Broadbent**, external member of the Monetary Policy Committee, gave evidence.

Q1 Chair: Thank you very much for coming to give evidence to us this afternoon, particularly because I gather you are feeling slightly under the weather. Could I begin with a question from the financial stability field? How confident are you that you can spot major long-term corrections in asset prices?

Dr Broadbent: We can certainly spot shifts in risks of major corrections. We have some ability to say something about what the fundamentals might mean in particular asset markets.

Chair: I am afraid you will have to lean forward towards the microphone.

Dr Broadbent: Sorry, forgive me. We can say something about the fundamentals and we can make judgments, therefore, about the likelihood that particular asset markets or particular prices are too high or occasionally too low, but I do not think it is possible to say that very accurately and nor is it possible, even if there is what might be called a bubble or a trend that is getting increasingly overvalued, to say exactly when it might be corrected.

Q2 Chair: I was asking particularly about corrections—values; markets that are adjusted; markets that are undergoing fundamental

upward price movement, for example. How confident are you that you can spot that?

Dr Broadbent: What, corrections from those levels or that we can say—

Chair: Corrections to those levels—upwards, I mean.

Dr Broadbent: I understand. Perhaps I can phrase it this way and if this is right you can tell me: “How much is sort of fundamentally driven and how much is not?” Is that a fair way of phrasing your question?

Chair: I am asking you whether you can spot when a market is undergoing a fundamental upward adjustment.

Dr Broadbent: Okay. To some degree, yes, I would say. I would not say we can be fully confident.

Q3 Chair: Therefore, to some degree, no.

Dr Broadbent: Yes, exactly. I do not think—

Q4 Chair: I think that is a very reasonable reply, but that means that there will be some that you do not spot.

Dr Broadbent: Correct.

Chair: Therefore, some that you might misinterpret as a bubble?

Dr Broadbent: Absolutely right.

Q5 Chair: Therefore, there will be occasions when you have a go at a bubble, thinking it is a bubble, but it turns out you will be sending it to a headwind that was not a bubble at all, but a fundamental shift in the market?

Dr Broadbent: Yes. If you are thinking, say, of house prices over the last 20 years, my own view is that it is quite a definite move and they have been fundamentally driven. That said, my own belief is that, whatever the asset market, perhaps the most important thing for financial stability is not simply a move in prices and to what extent it has moved too far or to what extent it is being driven by sustainable moves and fundamentals, but how much credit is being taken on, on the back of those moves. To use the example of housing again and to take an extreme example, if all the transactions are happening and they are being funded purely by cash, then, even if the prices are overvalued, that would be much less serious than if you saw people buying at prices that were too high with a lot of debt.

Q6 Chair: If we are all agreed that you cannot spot all fundamental upward adjustments and that some of them you will misinterpret as a

bubble, it follows that sooner or later the banks are going to have a crack at bursting the bubble that turns out not to be a bubble and getting—this is mixing the metaphor up—egg on your face.

Dr Broadbent: Let me go back to the answer I gave a moment ago, because I think it is relevant here. I think it is more important that macro-prudential policy, the policy of the central bank as a whole, should be set to ensure that, whatever one's view of prices, there is not too much risky credit taken out on the back of it. I do not think it is primary purpose, say, of the FPC to spot and burst bubbles. I say that because, even to the extent they exist—

Chair: Could you say that again? You don't think that—

Dr Broadbent: I do not think the primary purpose of the FPC is to spot and burst asset price bubbles. I think what matters for financial stability, which is its primary goal, is the extent to which purchases of assets that may be overvalued are financed with debt. That is what makes them most dangerous.

Q7 Chair: But you are basically saying that you do not see that you can necessarily spot a bubble?

Dr Broadbent: I am saying that, but I am also saying I do not think it is the primary objective of policy to control prices per se anyway.

Q8 Chair: Far be it for me to want to set you off against the Governor, but the Governor has described the belief that bubbles cannot be identified as market fundamentals with which he disagrees or thinks that contributed to the financial crisis. I was surprised by that remark, myself. It sounds as if you are.

Dr Broadbent: I think it is wrong to imagine that there are only two extremes: that either one knows everything or knows nothing. The point is—

Q9 Chair: If you do not spot some bubbles then you are going to try to puncture ones that are not bubbles.

Dr Broadbent: You can say something about risks, but I come back to the point I made earlier. As I say, take an extreme example, take the housing market now and imagine that you do know the rateable value but imagine, too, that all the buying of these overvalued houses is being financed entirely with cash. To my mind, that would be a much less serious problem and, therefore—

Q10 Chair: We might get into the housing market in a minute.

Dr Broadbent: Okay. No, but my point is—

Chair: What I am trying to do is just look at this issue as a level of proof.

Dr Broadbent: I understand that. I am saying neither that one knows nothing nor that one knows everything, but I am also saying that it is not the overarching objective to control these asset prices in the first place.

Chair: There seems to be a heck of a lot of shuffling around in the Committee this afternoon. What is the problem? I think we can all hear one another can't we?

Dr Broadbent: Yes.

Chair: Good. Let us carry on. Suddenly the microphones have moved from very limited life to being very noisy. Does anybody else want to come in on the asset bubbles point before I move on? Two colleagues do.

Q11 Steve Baker: I wanted to go through two threads here. First, when you are talking about credit risks, is it not the case that most of the risk models are still based on a normal distribution of market events and has it not long since been proven that market events have a fatter tail than a normal distribution gives them?

Dr Broadbent: I don't think it is the case within banks' models and I am no expert on precisely what models they use. It is certainly not the case, for example, in mortgage markets where what you focus on is the tail of the mortgage borrowers. It is not the case that you simply imagine that thing is uniform. You are absolutely right to say that the models being used pre-crisis for many financial asset markets were too simple and modelled as if they were, if not normal, then at least vaguely symmetric distributions. That was clearly wrong. What we learned, or rather re-learned, in the crisis is not only are there fat tails but they will become fairly correlated during the downturn. I don't know that it is the case they are all still like that. I would imagine not, but I can't give you a full answer.

Q12 Steve Baker: If I may, the other one is, since we are on bubbles, I think you and the Governor have both said that the housing market is the greatest risk to the recovery. I am getting a bit ahead of myself but, back in June, Andrew Haldane suggested to Mr Garnier that you, the Bank, had blown the biggest bond market bubble in history.

Dr Broadbent: Yes.

Q13 Steve Baker: Which is it? Is it both bubbles or are we blowing bubbles everywhere?

Dr Broadbent: Andy is the master of a colourful turn of phrase, but I would disagree with him. Let me point out a couple of things about bond yields. I can tell you that over the last 300 years, if you want a number, gilts have yielded, in real terms, somewhere between 2.5% and 3% a year. In the early 1990s—

Q14 Chair: Could you explain that?

Dr Broadbent: Yes.

Chair: There must be some correlation.

Dr Broadbent: Exactly. That sounds like a reasonable number and you get a similar figure for the long-term ex-post yield on US Treasury. In the 1980s and early 1990s they were significantly higher than that, at over 4%. You then saw a marked decline, in other words a marked rise in bond prices even allowing for the effects of lower inflation, long before the financial crisis. Ten-year real yields, for example, went from 4.5% in the early 1990s all the way down to 2% by the end of that decade. Even prior to the financial crisis they were well below 2%. The bulk of the fall in real yields happened long before the crisis or QE or anything else.

You may remember there were people, I think it was Greenspan, talking about the conundrum and whether it was savings imbalances and so forth. There were all sorts of potential explanations globally for that, but I think it's a mistake to believe that every move in long-term bond yields is driven by central bank policy. I just don't think that is true. It is true that our estimate, certainly initially, is that QE reduced them further and I think that was entirely appropriate given the crisis. My own view would be probably that that effect has faded slightly and that there are still these deep factors independent of central bank policy that are keeping real yields low.

I do not think it is fair to say that this is necessarily a bubble in bonds. Even on houses, it may depend which part of the country you look at. I tend to think a good measure is to look at rental yields and compare them with some financing costs. Outside London those rental yields do not look too low to me. They look roughly—

Q15 Steve Baker: If I may, is it conceivable that the history of bond yields prior to the crisis was itself a product of monetary policy at the time?

Dr Broadbent: No, I don't think so. Most monetary economists would say that policy can certainly affect real things in the short run, but the further out you go real things are what affect real prices. It may be true in this country that once you introduce inflation targeting you reduce, to some degree, what was an inflation risk premium in the gilts market, but I don't think it was low levels of short-term nominal rates that drove that decline and certainly not our own rates. We live in a global capital market and there were global factors that drove a lot of that fall.

Q16 Chair: Just go back to this bubbles point as a matter of principle; are you confident that there are some bubbles that can always be identified?

Dr Broadbent: No. As I said, it is a probabilistic thing. You can say, “It looks as though this asset’s price is quite high relative to average”. The Bank has said that, for example, about some options prices and about market implied volatilities currently.

Q17 Chair: We must accept that there will be bubbles that are not identified and that they will subsequently lead to a financial crisis?

Dr Broadbent: Possibly, but, as I said, the crucial thing—and I think it wasn’t simply the fact that some assets got overvalued in 2005, 2006 and 2007; housing in the United States in general. What mattered—

Q18 Chair: No. I am trying to keep it as a matter of principle.

Dr Broadbent: I understand, but I am just saying that I think what is crucial is the extent of leverage on the back of that and that is what, primarily, macro-prudential policy is designed to control.

Q19 Chair: Can I take you to a very interesting reply you gave in the questionnaire—this was to the last question, which was on the housing market, question 19—where you argue that the FPC could intervene in the housing market under its secondary objective? It relates directly to what you have just said, in that highly leveraged households might cause the economy to be more volatile and it is the volatility that one would want to address.

Dr Broadbent: Exactly.

Chair: Can you just say what you mean by that because I wasn’t quite sure? Are you saying that the FPC has a role in smoothing out volatility?

Dr Broadbent: Some.

Chair: It does?

Dr Broadbent: Some, I think. Some have made that argument for monetary policy in the past, that it should give some weight to ensuring credit—

Q20 Chair: Monetary policy is a very different kettle of fish.

Dr Broadbent: No, I understand that. What I am saying is that it might be an objective of public policy of some sort to prevent leverage from growing too quickly because, even if it is not in the environment of a bubble and even if we are not talking about something as dramatic as a financial crisis, it would make the economy in the end more sensitive to shocks of all kinds: changes in interest rates or changes in unemployment.

Q21 Chair: You think the FPC might go with its secondary objective in order to justify action, possibly the use of macroprudential tools to reduce volatility?

Dr Broadbent: The primary objective is the primary objective. Most of the time we are acting solely with regard to that. If you had two things that had the same effect on the primary and one of them gave you slightly more stability—

Q22 Chair: I am just trying to shave that away that, using Occam's razor and leaving behind the secondary objective.

Dr Broadbent: I understand. This is a hypothetical thing. I am not necessarily talking about what the FPC is thinking of doing, say, on the housing market and the options it presented in the last FSR. I think those are primarily directed on the grounds of the primary objective.

Q23 Chair: You would be going to the public then, trying to explain why you were acting in that way using a secondary objective. The FPC has a public explanation role.

Dr Broadbent: If it were solely that, yes. I put that line because I was asked the question in the questionnaire. To imagine the circumstances in which it would solely be for that is difficult. Those occasions when you were doing something so forensic that it had nothing to do with financial stability and was only to do with the Government's objectives for growth would be rare.

Q24 Chair: I am just looking at the wording of your reply, but what you are basically saying is that there may be a supplementary reason for arriving at the secondary objective.

Dr Broadbent: That is exactly how I looked at it, yes.

Q25 Chair: You don't think that the secondary objective alone is likely or it is only scarcely conceivable?

Dr Broadbent: Exactly. If you tried to imagine circumstances where it was only that, I think they would be rare.

Q26 Chair: That is not quite what it says here, but it is a very helpful explanation and clarification. You do say, in fact, that leverage may be sustainable in the sense that mortgage defaults are likely to remain low and still be high enough to make the economy over-sensitive to shocks—"This in turn would make the economy more volatile"—and, in principle, you justify action—

Dr Broadbent: Yes, but, as you put it, a sort of supplementary question because high leverage also affects financial stability.

Q27 Jesse Norman: Dr Broadbent, you will understand why we are thinking about bubbles, given Governor King's remarks about the importance of taking away the punchbowl when the party really gets going. I think that it is bubbles that he is talking about. He is talking about the ability to identify when conditions have become too overheated and asset prices have started to accelerate and, therefore, it is time to do something about it. I just want to ask you about that. Obviously, just to pick up a point that the Chairman made first, there are two kinds of things the bank might try to do or two problems it might have. One is to identify something as a bubble that is not a bubble, in which case its action would be positively deleterious—

Dr Broadbent: Indeed. Exactly.

Jesse Norman: —or it might fail to identify a bubble that was a bubble. Now, am I right in thinking that this introduces an asymmetry—you will be so keen not to misidentify a bubble that some bubbles will get through?

Dr Broadbent: Potentially, but ideally not. There are these two types of errors, as you say, and we should be aware of both of them. I come back to what I said earlier. Remember that it is not the objective, not of monetary policy certainly or even of macroprudential policy, to target asset prices.

There will be, for reasons that we discussed earlier, fundamentals certainly that have driven up, say, house prices over long periods of time in this country and those fundamentals may well continue to drive up house prices. I think it would be wrong to say we are going to try to have some particular target. What matters, for financial stability certainly, is the amount and the riskiness of debt that is used to finance purchases of assets at prices that may be overvalued. I want to emphasise that this is not about a particular target, prices. It is not the primary purpose to identify and burst bubbles.

Q28 Jesse Norman: You will be looking at both sides of the balance sheet then from an FPC standpoint?

Dr Broadbent: Well, certainly, and certainly I think what is important is the rate of growth of mortgages, which at the moment is very low in aggregate, but, in particular, the rate of growth of risky mortgages.

Q29 Jesse Norman: What do you do when you get a massive disparity between one part of the country and another and yet you have relatively blunt tools on the FPC? What is the solution to that problem?

Dr Broadbent: Monetary policy, of course, we set for the United Kingdom as a whole. It is possible to imagine in principle instruments that differentiate across regions, but in practice—you say it is blunt—the likelihood is that if you did something that sought to limit the growth of risky lending, say, then that would have the bigger effect precisely in the regions that are seeing the fastest growth. I think I said this in the questionnaire. An instrument of policy need not be regionally specific to have regionally differentiated effects. It would act precisely in the parts of the country that you need it most to work.

Q30 Jesse Norman: Yes, and if you set thresholds in a certain way it is going to affect different parts of the country in different ways, obviously.

Dr Broadbent: Quite.

Q31 Jesse Norman: Yes, that is right. One of the recommendations of the European Commission was to look at changing the taxation of housing. Can you ever imagine the FPC giving a recommendation to the Treasury to use fiscal measures within a market for macro-prudential reasons, whether in housing or anywhere else?

Dr Broadbent: I would feel quite nervous about doing that. There was a pretty comprehensive list of options laid out in the last financial stability report and that was not one of them.

Q32 Jesse Norman: That is a psychological reflection of your view, but you do not think the FPC would ever contemplate it?

Dr Broadbent: I think I said in my answer that macro-prudential policy is in its infancy and I am even greener than the policy itself, so I do not know.

Q33 Jesse Norman: You find it hard to imagine the FPC—

Dr Broadbent: Yes. Generally, my own instinct, speaking for myself, would be to be wary about something like that, yes.

Q34 Jesse Norman: That is interesting. Obviously, you are taking this job in the area of monetary policy and you have been on the MPC as well as the FPC. Therefore, you have presided over quantitative easing and you have had a share of responsibility for QE. When the Governor talked about inclusive capitalism, do you think that he ought to have been thinking about the distribution effects of quantitative easing, which has been to make a lot of rich people a lot richer and to take away quite a lot of money from people who do not have much money?

Dr Broadbent: Any monetary easing has at the margin—I use that word advisedly and I will come back and say exactly what I mean by that—distributional effects. Any easing in

monetary policy tends, at least in the first instance, to redistribute bits of income away from creditors and to debtors and, similarly, tightening does the opposite. Over time, of course, there will be equal numbers of episodes of tightening and loosening.

I say “at the margin” because the goal of policy is to stabilise and, during a downturn, to increase specifically the amount of output and income for everybody. One has to remember what the counterfactual is. One talks about distributional effects, but my own view, very strongly, is that if we had not had QE, if we had not had the dramatic easing in monetary policy we had in 2008-2009 across the developed world, we might have suffered something like the Great Depression. Therefore, frankly—

Q35 Jesse Norman: Of course, it would not be inconsistent with that view to say it was necessary but it is a tremendous shame that it has had the distribution effects that it has had. Obviously, one of the things it has done has been to pump up asset markets and in order to benefit from those you have to be one of the households in this country that has assets, of which there is a very small—

Dr Broadbent: Well, many households do. They have pension funds.

Q36 Jesse Norman: That is true, but a very small percentage of people have stocks and shares that will have benefited from those rises.

Dr Broadbent: No, I do not think so. Most equities held by UK residents are held in pension funds, the majority.

Jesse Norman: Of course.

Dr Broadbent: I think quite a number of people will have benefited from any effect of QE on asset prices. They may not have been very visible to them, particularly since, first, you are talking about the value of something that you cannot see directly and, secondly, it is relative to some counterfactual in which things might have been worse, but I think it is true that a large number of people did.

Q37 Jesse Norman: Apropos the Governor’s words at the Inclusive Capitalism conference, if it is setting itself as a matter of policy in favour of a more inclusive capitalism and against, by implication, some of these egregious distributional effects that people are worried about, then you would expect the Bank to have a worry in it about the distributional effects of QE, would you not?

Dr Broadbent: In an ideal world, you would not be engaged in redistribution of income but, as I say, that is true, at least in the short run, of any certainly surprise change in monetary policy. It is less clear if people have time to prepare for it. As I say, also, on average, episodes of tightening are as common as episodes of loosening—otherwise, interest rates would trend forever in one direction or the other, which they do not. In any

case, I would describe these as not necessarily marginal in size but certainly secondary relative to the effect you have had on the aggregate.

Q38 Jesse Norman: I am not suggesting you should or should not, but I am just asking as a matter of fact whether you see it as part of your remit on the FPC or the MPC to consider the social implications of decisions that you take.

Dr Broadbent: Yes. I think the Governor also said in that speech, of course, that the primary objectives we have are there precisely because they are social goods. If anything, if they have distributional consequences, high inflation and certainly surprise increases in inflation are probably regressive and they hurt those on fixed nominal incomes, including the retired. These objectives exist precisely because they are socially the right thing to aim for.

Q39 Jesse Norman: Yes. One of the things that the Governor also said in his speech, one of the things that made it so interesting, was that, in addition to the financial reforms that had already been undertaken, a welcome addition would be changes to what he called the hard and soft infrastructure of financial markets to make them dynamic and fair. Do you have any thought as to what he might have meant by “changes to financial markets to make them dynamic and fair” over and above the things that have already been done?

Dr Broadbent: No. I think, broadly speaking, he meant to make sure access was broadened to ensure that prices fairly reflect fundamentals, to ensure that some participants do not have material advantage. The most egregious example would be insider information of some sort. I imagine that is what he had in mind.

Jesse Norman: I want to talk about Draghi, Chairman, but I do not want to tread on anyone else.

Chair: Go ahead.

Q40 Jesse Norman: Just very quickly then on the issue of Mario Draghi and what has been happening in the eurozone, can you briefly summarise what you think the threat is at the moment and how you assess the situation in the eurozone? In particular, do you think Mario Draghi has done enough to address whatever the threat is?

Dr Broadbent: The first thing I would say is that it is not solely Mario Draghi who is responsible for ensuring that the eurozone gets into a sustainable place.

Jesse Norman: The ECB and, yes, others.

Dr Broadbent: No, but even the ECB. What we know is, and the Governor referred to some of these points in his speech about Scotland, in order to support a common currency

you need certain amounts of fiscal risk sharing or risk sharing across the financial system that are deeply political questions among a group of sovereign states. That is a long journey that we have just begun towards a “banking union” of some sort, a fiscal union of some description. I would describe that as a necessary journey to make and the ECB alone cannot ensure that all the conditions are met for a sustainable eurozone.

Q41 Jesse Norman: The steps that Mario Draghi took last week, what is the threat he is trying to head off? How do you assess it and is he succeeding? Is it an adequate response?

Dr Broadbent: I think it is very welcome. Having said that you have to make this institutional journey, what is also true is that there remain quite severe imbalances across countries within the eurozone and it is probably true that the peripheral countries are less competitive still or only competitive with large numbers of people out of work relative to those in the core. You need to see further wage and price productivity adjustments.

In the meantime, price inflation everywhere, but especially in those peripheral countries, has fallen to quite low levels. I think it was absolutely right and welcome that the ECB addressed that, which is what they were trying to do—to ease monetary policy but also, in a fashion that is similar to our own FLS, to help reduce the funding costs of banks specifically in order to increase their lending to the real economy. That was probably the more important part of the package.

Q42 Jesse Norman: You think that will be enough, do you?

Dr Broadbent: What we know already is that, relative certainly to a couple of years ago, what was done or what was promised and what was said have been enough to lead to a material reduction in funding costs of the banks. I think it was a very important part of the fall in the funding costs of our own banks and, therefore, our own economic recovery. It is very welcome that he has gone that much further and especially that he has introduced this scheme to reduce banks’ funding costs and incentivise lending.

Q43 Chair: Let us come back to the very first answer you gave Jesse Norman when you said you did not think that the bank would want to get involved in housing taxation. That does rather beg the question whether you think it is a good idea for the European Commission to get involved in housing taxation. How do you feel about that?

Dr Broadbent: Nervous as I am in advising the UK Government what to do with its taxes, I feel even more nervous about advising the European Commission what to do.

Q44 Chair: Not their bailiwick?

Dr Broadbent: This is political territory, Chairman. All I can do is speak for my own view about the approach the FPC should take to its powers and to have some regard for—

Q45 Chair: If the UK financial stability regulator, which has been given a very wide discretion and could demand this—it would not necessarily get it, but it could demand it—has decided better not—

Dr Broadbent: I would be nervous, but I cannot speak on behalf of—

Chair: —that rather begs the question whether the European authorities should get into this territory.

Dr Broadbent: The FPC powers of recommendation are quite strong. I think it would mean quite a lot for the FPC to recommend something. It has other sorts of powers that are even stronger powers of direction, but even the recommendation is quite strong. I do not know what the Commission has said, but if they had just said, “We think this would be a good idea”, then no one is bound by that, presumably.

Chair: Okay, thank you for that.

Q46 Mark Garnier: Could I turn to the question of interest rates recovering back to a normal level? Charlie Bean has argued that in the decade leading up to the financial crisis the bank rate average was something in the region of 5 percentage points, but he reckoned that, I think because of headwinds and global forces in three to five years’ time, the main level of the bank rate is going to be more like 3%. Although he does not necessarily say that will be an average, he says that is where he reckons it is going to be in three to five years’ time. Do you agree with that? What is your view on where interest rates will finally settle down for a long-term post-crisis period of normalcy?

Dr Broadbent: Charlie has the advantage of knowing that he is not going to be here when those interest rates are set. That may have freed him to make a prediction numerically that I would feel reluctant to make. What I certainly believe is there are all sorts of reasons—some of them I mentioned to Mr Baker—about why interest rates, the neutral level of rates if you like, are likely to be quite a bit lower. Now, there are long-run trends globally that can mean that is not the case, but certainly three to five years, there are all sorts of reasons—about high levels of risk aversion globally that prevailed before the crisis, still high levels of saving in some parts of the world, particularly Asia, and about wider spreads in this country between risk-free rates and risky rates—that would tend to make things lower as well.

Q47 Mark Garnier: I am going to come to that, but you have triggered the point about the spreads between risk-free rates and risk rates. Did I hear you say that you reckon the spread will be wider because the risk-free rate will be lower?

Dr Broadbent: No. The spread will be wider just because of more prudence and more prudential regulation of banks, basically. If you look back to certainly the latter part of the expansion just before the crisis, average mortgage rates were no higher than Bank rates.

That does not seem very sustainable and there is every reason to think that that spread will be wider.

Q48 Mark Garnier: How much wider? This is quite an important point because the MPC is sending a message by increasing its base rate. The FPC, of course, has a mechanism whereby it can put pressure on the banks in order to be more prudent and, therefore, be wider than that rate. However, the big challenge facing the Bank of England and the MPC and the FPC is, when interest rates do start to normalise, to what extent do you have control over the rates as they arrive on people's doormats in terms of the shape or the cost of their mortgage?

Dr Broadbent: In mortgage space narrowly, a fair amount. If you look at what happened to spreads between bank rate and average mortgage rate, certainly the flow, they widened. They are already much wider than they were, so the average rate on the stock of mortgage debt is somewhere between 2.5 and 3 percentage points wider. I told you it was more or less zero in 2007. There is a big chunk of that stock that is automatically tied to Bank rate and to that extent we do know, but you are right, we have to—sorry?

Mark Garnier: The new mortgages are less so.

Dr Broadbent: Yes.

Q49 Mark Garnier: My real concern with this, and there is an interesting problem between the fact that as interest rates go up—obviously it is determined by the Bank of England, who are not politicians—and, of course, the crisis that could result as a result of rising interest rates with that very large stock of household debt, which could, in fact, be more of a policy mechanism. I completely understand the problem you have because you are trying to deliver monetary policy, which cannot be looking at the extremes of the standard deviation curve, the tails of the curve, but, nonetheless, the actions that the Bank of England takes can ultimately push significant numbers of households into problems.

Dr Broadbent: Let me say a couple of things. First, that is precisely one of the things that the MPC would take into account. A rise in interest rates, when it comes, is not something that happens whimsically or arbitrarily. It happens for a reason, which is that the economy is growing strongly, that unemployment is falling, that the spare capacity is being used up, and that inflation pressure two or three years out would be growing. That would be the reason for higher interest rates. In that environment, the economy could tolerate higher interest rates. Indeed, it would require them. That would be precisely the judgment. It is very much part of the calculation to what extent rises affect demand in general, including household demand in particular.

Now, clearly that is going to be more sensitive than it was, on average, over the past because debt levels are higher than they were, on average, over the past, but it is also true that they are lower than they were five years ago and that the levels of default and arrears at that time certainly were much lower than they had been, say, in the cycle of the late 1980s and early 1990s. One would not want to get anywhere close to that, of course. In an environment of falling unemployment, which is the thing that most strongly affects arrears and defaults, it is possible to exaggerate that effect but it is, as I say, very much one of the things that the MPC would be thinking about. Indeed, it is probably one of the reasons why the MPC was prepared to say in February that the rise, when it comes, is likely to be gentler.

Q50 Mark Garnier: Yes, and, as Martin Weale has talked about, baby steps, which I think is quite encouraging.

Dr Broadbent: Indeed.

Q51 Mark Garnier: There was one last question on forward guidance, a very interesting concept brought in by Mark Carney. I think everybody at the time found it very helpful and, even though the original terms of forward guidance have slightly fallen by the wayside, it has given people food for thought. There are a couple of comments. I think there was one this morning on the radio, where they were saying that a lot of businesses have now decided that forward guidance has given them a great deal more comfort about the path of interest rates and, therefore, there is more investment and businesses are now spending more money. That is a good thing and we are pleased about it.

However, the other side of that is perhaps suggesting that some businesses are now being distracted away from the risk of rising interest rates and how it may affect their business and that, in fact, what we are now seeing is a rush to spend based on a false assumption that interest rates are probably not going to rise in the way that maybe people thought they were and, therefore, businesses are not making that preparation.

Dr Broadbent: Well, I have to say when I look at, say, business lending in aggregate or even in its pockets, I do not see a huge increase in credit—quite the opposite; it is still declining. There may be pockets. I mentioned earlier options prices, some areas of implied volatility in financial markets, where the assurance of lower interest rates has encouraged more risk taking than one would like. However, in terms of non-financial businesses in the UK, I do not think that is true because their debts are still declining and, relative to incomes, household debts are declining.

Q52 Mark Garnier: Yes, but that is because we have a lot more people coming into work and household incomes are not going up substantially, but it is still resolutely stuck at that £1.46 trillion, £1.47

trillion, as the household debt number. It has been there now for five or six years.

Dr Broadbent: Yes, but relative to income it has fallen about 20 percentage points, aggregate household disposable income.

Q53 Mark Garnier: Yet the OBR is suggesting that it is going to go from that 145% level where it seems to have bottomed out at back up to 170%.

Dr Broadbent: Let me make a couple of points here. First of all, do not see this in isolation. If I look at net household financial wealth, it is higher relative to income than on average over the past. What has happened over the last generation is that both sides of the balance sheet have grown. That has happened because house prices have gone up and new people coming into the housing market or buying bigger houses are having to borrow more than their predecessors did and they are paying that money over to people moving down the housing market who, therefore, have more cash and more assets. The net position is not nearly as bad as you would think just looking at gross debt. Of course, it is a risk that these are different people. It is a risk, and that is precisely why we have to think about it, but—

Q54 Mark Garnier: For different reasons. Sorry to cut across you, but Mr Norman made a very good point. He said you would look at this balance sheet but it is very fragmented. You have regional fragmentation. You have social fragmentation. You have all sorts of different things. I have not seen the hard numbers, but certainly anecdotally quite a lot of money has been coming into London seeking a safe haven from the eurozone crisis—money coming in from the Far East, Latin America, Russia and wherever. You have quite a lot of different dynamics that, being a cautious man, I feel is slightly worrying because, if you do see sustained stability in the eurozone, will that Greek money go back to Athens? If you do see the rule of law in Russia getting better, will that money go back to Russia? Ditto China, ditto India, ditto Brazil or whatever. If you start taking that money out of the balance sheet completely away, then your balance sheet for the country might start looking a bit more fragile.

Dr Broadbent: Those numbers are interesting, but they are very small relative to the aggregate. They are very small. Furthermore, what we are concerned about here is not the aggregate, as you say, but the tails. If you look at the number of defaults, repossessions, over the three worst years, 2008, 2009 and 2010, they are about 1% of mortgaged households; say 0.5% of households, about half the rates we saw earlier. That is a very severe event, clearly, and you do not want that to happen and you do not want the risk of that to be found, but it is precisely because there is a lot of variation that what matters most, I think, is looking at the rate of growth of high mortgages, risky mortgages, higher mortgages relative to values of houses and relative to income.

Mark Garnier: Just one tiny little one because I am slightly—

Chair: You said that some minutes ago.

Q55 Mark Garnier: I did, but there is a tiny one about forbearance. It is the forbearance. You talked about businesses and you talked about households, but what about the banks? If the banks are offering a lot of forbearance, which may be hiding what is going on in the mortgage market—at the moment, at 50 basis points a bank can finance a bad mortgage for 200 years before they have lost all the money, in very crude terms. If interest rates start going up and the base rate starts going up and the inter-bank rate starts going up, it is likely to cost them a lot more to offer forbearance to those difficult households. Are you comfortable that that is not going to suddenly unleash another—

Dr Broadbent: Let me say what I said earlier. This will be a consideration as regards the pace at which interest rates would have to go up. What you want to do is to stabilise the economy. Obviously, if one given change in interest rates has a more powerful effect you would do fewer of them. You would not just arbitrarily carry on anyway. Secondly, we can look at this. We can look at the behaviour of arrears over the past and we can come to some judgment about what changes in interest rates do. The fundamental point is, as I said earlier, that this is not some arbitrary decision and so the effects it has on the economy are very much part of it.

Mark Garnier: Okay, thank you. That is very helpful.

Q56 Steve Baker: Just turning to the unwinding of QE, earlier on we discussed Andy Haldane's comment about the bond market, although I just remind the Clerks that we had that conversation then. You particularly, in your answer, drew a distinction between the short-run monetary factors and the long-term real effects.

Dr Broadbent: Yes, indeed.

Q57 Steve Baker: Forgive me because I am a simple engineer who has read a bit of economics; I am trying to understand this. QE and monetary policy affects the capital markets. The prices in the capital markets surely affect the allocation of capital and surely the allocation of capital still has something to do with the means of production. How can it be that within that chain there is a break between monetary policy and the allocation of capital into the means of production?

Dr Broadbent: Well, in the short run there is not a break and they do have effects. The monetary policy does have real effects, but over time, once the prices of goods and services adjust, you would not expect to see a powerful effect. I think there is a distinction between what economists call, slightly vaguely, the short run and the long run. If you are

asking about whether the unwinding of QE would have an effect, then potentially yes. I said to Mr Garnier a moment ago that we have some history of looking at effects of interest rates, whether on the economy overall or the household sector specifically. Clearly, we have less experience of asset purchases, none as yet of sales, and we know from what happened in the United States last summer that markets can get quite jittery if they are uncertain about those flows. It will clearly be very important to think about decisions.

Q58 Steve Baker: As the asset purchase facility is wound down, presumably you would expect to see those reserves deleted just as they were created. Perhaps you could confirm that in a moment, but also what would you expect to be the effect on the structure of prices in the capital markets as that process takes place?

Dr Broadbent: Again, I should emphasise right at the beginning exactly the same as I said a moment ago. This is not some arbitrary decision. It seems likely to me that the asset purchase facility will be unwound at a time when risk appetite is improving, when the demand for highly liquid assets, therefore, is falling, and when the supply of gilts from the Government, at least relative to GDP, is also falling. All those things help absorb any sales. As regards the level of reserves, there may be other reasons why banks want to hold more reserves in a sustainable fashion over the longer term quite independently of QE, so I do not want to say the level of reserves will go back to where it—in fact, I strongly suspect they will not go back anywhere close to where they were before the crisis. That is a slightly separate point.

Q59 Steve Baker: Before we go too much further on reserves, could I just pick up on this point? From what you have said, I am inferring that you do not expect the unwinding of QE to have a material effect on asset prices.

Dr Broadbent: I do not think that is the case. I am suggesting that we would do it in the context of wanting to withdraw some monetary easing, i.e. in the context of having an economy that would be able to absorb it. Having said that, we know from what happened last summer that there is a potential for great volatility here as this happens. We know that. Since then we have seen compression in some risk premia, and particularly in implied volatility in some financial markets, go even further. We would have to think about that very carefully. I certainly do not think that it would have no effects at all. I think it would. What I am saying is that, in expectation at least, the direction of the effects is precisely the one that you would want. That is why you would be doing it. Second, having said that, it would be very important to communicate very clearly, in advance, the conditions that would be necessary to have this happen in order to try to limit volatility in reaction to the unwinding of the QE.

Q60 Steve Baker: Is there not a tension between the macroeconomic effects that you are aiming at by manipulating quite large aggregates and

the microeconomic effects that those manipulations have on particular prices and particular assets and the consequent effects on—

Dr Broadbent: Possibly. Absolutely, I think we should be aware of those. That is the context in which we look at and think a great deal about compressed premia in some markets and why we have communicated some unease with that.

Q61 Steve Baker: You mentioned the larger reserves you think it is likely that banks will hold. What will it mean for the economy for those larger bank reserves to be in existence?

Dr Broadbent: Not first order. I do not think it will have a huge effect. The purpose of the sterling monetary framework is to accommodate movements in the demand for reserves precisely so they do not have first order effects. Demand for money goes up; you supply that extra reserve in order to keep interest rates roughly where they are. I do not think it will have a material effect. What is true is that one of the reasons why banks are likely to want to hold more reserves is because of more prudential regulation more prudence generally, and that is also likely to imply, as I said earlier to Mr Garnier, slightly wider spreads, say, in retail interest rates relative to risk-free rates. In and of itself, I do not think the higher demand for reserves will have first-order effects.

Q62 Steve Baker: You have talked about the periods of expansion and contraction being about equal overall, but would they not hit very different individuals at different times and, therefore, have distributional effects which tend from the individual's point of view not to be equalising over the course of the individual's lifetime?

Dr Broadbent: That may be true. This crisis, its effects and its aftermath have lasted a long time. I accept that point.

Q63 Steve Baker: I am thinking about the Occupy movement. I went down to see them and listened very carefully to them. It is surprising how well read some of them were. They did not fit the caricature that is applied to them. Is it not quite possible, bearing in mind the trajectory of M4 over the decade previous to the crisis, that these various expansions and contractions in the money supply have manufactured injustices as far as individuals are concerned that cannot just be brushed away by looking at aggregates?

Dr Broadbent: No, I think that is quite possible. I quite accept that.

Q64 Steve Baker: Thank you. Just a final point then, as a consequence of that: would you accept that there are profound political consequences that arise out of the actions of the Bank of England?

Dr Broadbent: No, because I do not accept necessarily that the trends you alluded to are due to things that the Bank of England did. There were all sorts of things. The global decline in interest rates I mentioned earlier led to what, clearly in hindsight, was a vastly excessive growth in banks' balance sheets.

Q65 Steve Baker: What I am hearing you say now in the course of that exchange is that you accept it is possible that monetary policy has manufactured injustices severe enough to have brought the Occupy movement out and yet that does not have political ramifications.

Dr Broadbent: No. What I accepted was that the rapid rate of growth of banks' balance sheets may have resulted in injustices. I do not accept the Bank of England monetary policy generated them, a slightly different point, and I certainly do not believe either that monetary policy was the cause of that huge expansion or whether UK alone trying to act could have done much about it, quite honestly. I would draw that distinction.

Q66 Chair: On the unwinding of QE, there are all sorts of things that can be done but perhaps there are three possible policies. One is just to allow QE to run off as the debt expires; one is to accelerate that process with gilt sales, overfunding—it has many of the characteristics of overfunding; it is not quite identical, but it has many of the characteristics of it—or take a judgment on the size of bank's balance sheet and say the balance sheet should be bigger, in which case you do not run off all the QE. You keep some. I am going to ask you a question but, by all means, say whatever else you wish to say as well. Do you have a view on the size of the bank's balance sheet? Do you think it should be larger and, if so, how much larger?

Dr Broadbent: Let me refer back to the answer I gave some moments ago, which is that the size of the balance sheet is demand-determined and we do not prescriptively say, "It should be X". We did with QE, but the reason it is likely to be much bigger than it was pre-crisis is not because we have decided it should be, but because we expect that banks will want to hold a lot more liquid assets, deposits at the central bank in particular, as a result of larger sterling monetary-framework regulation, liquidity regulation in particular. I do not think it is an executive decision about what the balance sheet should be. It is a reaction. We accommodate—

Chair: I don't know whether I used the word—I hope I did—but it is an executive judgment about how much you think—

Dr Broadbent: The monetary framework is specifically designed, as far as reserves are concerned, to say, "The MPC sets the interest rate and then, roughly speaking, we want to supply a level of reserves that is consistent with that interest rate". That may grow and fall with the demand for reserves at a given time.

Q67 Chair: I am asking for your judgment on it.

Dr Broadbent: My judgment is that it is likely to be much bigger, not because of a decision that the Bank has taken but because of the forces that will increase the demand for reserves. That is completely separate—

Q68 Chair: Much bigger is what—double, treble the historic level?

Dr Broadbent: Prior to the crisis reserves were £15 billion. They are now about £300 billion. If you force me, I guess they would be at least halfway but I have no way of knowing. The point of this is that it is neutral. If you accommodate with extra supply an increase in demand it does not have a material effect. That is why you do it. That is a separate judgment from the unwinding of QE, which is a monetary-policy decision. In some sense we have excess reserves, at the moment possibly. You mentioned overfunding. Overfunding was a means of tightening monetary policy and that is the context in which the unwinding of the APF—

Chair: You made that point very clearly in an answer you gave a moment ago.

Dr Broadbent: Indeed. That is the context in which it would be taken.

Q69 Teresa Pearce: Dr Broadbent, in an exchange you had earlier with the Chair, when he was asking you about the housing bubble, it seemed to me that you were saying that if houses were all purchased with cash, that would not be much of a risk. The risk you envisage is if people become indebted and have large loans to service to purchase properties.

Dr Broadbent: Quite so. Yes.

Q70 Teresa Pearce: Do you think the Help to Buy scheme increases that risk?

Dr Broadbent: It is pretty small, frankly, in terms of numbers. If you look, for what it is worth, at the regional distribution, my judgment would be that of that small number the majority is in places where you are not seeing very rapid growth in house prices. So maybe at the margin, yes, but I think the numbers are relatively small.

Q71 Teresa Pearce: It does not give you any concern on financial stability.

Dr Broadbent: If you look at what the FPC said last November, it reserved the right, and indeed it has the responsibility now, to think about the Help to Buy scheme. I am just saying that in terms of the magnitude of its effects, I do not think it would be the first order.

Q72 Teresa Pearce: The FPC will be conducting a review in September. What will they be looking for there?

Dr Broadbent: Precisely those sorts of thing: to what extent is it pushing up numbers of people who have extremely high loan-to-value or loan-to-income ratios. That is the sort of thing I imagine it will be looking at.

Q73 Teresa Pearce: Commentators are saying that because of the Help to Buy scheme, particularly in London, house prices have risen and that is why banks now are reducing the numbers of mortgages they are giving.

Dr Broadbent: I do not think that is true. Nationally the numbers are pretty small. In London they are that much smaller and, therefore, to explain using Help to Buy why prices in London have gone up much further than they have elsewhere would be a bit odd.

Q74 Teresa Pearce: Why do you think prices in London have gone up?

Dr Broadbent: Partly the answer Mr Garnier gave. Certainly in pockets of central London it is being treated like a sort of gilt in the international market, some prices in Knightsbridge, and people just buy them. They buy them with cash and they do not care that they yield very little. They just want to hold them as security. That is part of the reason.

Q75 Teresa Pearce: When the FPC are looking at this, you think they have to look at London separately from the rest of the country.

Dr Broadbent: As I said to one of the earlier questions, you can take an action on housing, if indeed you judge it necessary, even if it, across the country, will have much more marked effects in some places than others, precisely because some places are seeing faster growth of loans and faster growth of prices. I do not think one necessarily has to think about regionally-targeted policies in order to have regional effects and specifically effects in the places you most want to have them.

Q76 Teresa Pearce: That is houses. What about the labour market? Do you expect further falls in unemployment?

Dr Broadbent: They are in our forecast. Our forecast, of course, has been not entirely perfect but, yes, it is in our forecast. We expect continued growth at a faster rate in productivity and demand and, therefore, further increases in employment.

Q77 Teresa Pearce: Pay growth, growth in wages?

Dr Broadbent: Average-earnings growth in real terms we do expect to start growing. Very recently it has continued to be weaker than we expected in the first few months of this year. I would anticipate that for two reasons. One, we think productivity will grow. That is an extremely difficult, uncertain judgment, but that is our best guess and it is certainly the

normal thing. It has not happened much over the last few years, but we expect a return to growth in productivity. That is one of the fundamental drivers of real average earnings.

Second, a welcome stabilisation in many of the big cost hits that hit the UK economy, most of them from overseas, particularly over the last four or five years—and I am thinking here of commodity prices, of import prices more generally—materially pushed up consumer prices relative to the price of the output that firms are selling and did material damage to real incomes. Those now seem to have stabilised and if we also get a return to growth in productivity I would expect them to grow. It is hard to be specific about when that will happen.

Q78 Teresa Pearce: Are you saying that the risks to that forecast are things you do not know about yet?

Dr Broadbent: Yes. We know what they are, but we do not know what is going to transpire. We hope that the risks will be roughly symmetric. That is why we make the forecasts we do.

Q79 Teresa Pearce: When you have made a forecast for pay growth, have you taken into account any income shifting that may have happened because of the reduction in the top rate of tax? People who have very large salaries may well have shifted their income to take account of the reduction.

Dr Broadbent: To a degree. We have tried to adjust for that. We thought there may have been some effects in the timing of the pay growth relative to last year. I have to say, looking at the most recent numbers this morning, it is not clear to me that that has been a major driver. We had thought that there may be a bit of income shifting, but it is hard to judge how much.

Q80 Mr Ruffley: Good afternoon, Dr Broadbent. The May minutes indicate that different members have different views on the central path, the rate at which slack will be taken up. What is your view on that central path?

Dr Broadbent: I think I would sign up, roughly. There are also different views as to the level now. Around 1% or so seems a reasonable number. It is difficult to be precise. It is not even something we observe directly, but it is clear that unemployment is still higher than what you might judge to be a long-run natural rate. The pace at which it absorbs involves two things that are always difficult to forecast and probably more uncertain now than we used to imagine before the crisis.

We have a forecast for demand. We have been relatively optimistic about that for the last 18 months and the economy has grown even faster than we had thought likely a year ago, but that has not led to the increase in productivity that we expected and spare capacity has fallen much faster, therefore. It is a very difficult judgment and I cannot say anything other than that to say whether that trend will change. If you look at long periods of time, it is

unusual to see our productivity growth much lower than that, say, in the United States—the country you might think of as the technological leader. That has been happening for the last three or four years. It seems to me it is unlikely to go on indefinitely, but saying it is going to end as it were in the third quarter of this year is difficult.

We have a forecast, therefore, that has some return to growth and productivity but not to above-trend rates. That seems the right balance to me, but I stress that this is an uncertain business.

Q81 Mr Ruffley: Thinking of productivity for a minute, one of the things that we know would improve that is an increase in business investment. What is your assessment of the level of business investment now at this stage of a recovery compared with previous similar recoveries?

Dr Broadbent: You have to be careful about whether you measure it in, technical things, current-price or constant-price terms. Certainly in growth rates in the overall balance of demand it looks, broadly speaking, like a normal recovery, if there is such a thing. You tend to see movement, at least in UK cycles and in the US cycles, first in residential investment. Then you get a bit of consumption growth and then you get business investment following. That is, roughly speaking, what has happened and it has grown a lot. Our forecast has much more growth and there may be risks to that. The weakness of eurozone growth is one difference relative to past UK recoveries, but the composition of domestic demand looks relatively normal.

Q82 Mr Ruffley: You said in reply to an earlier question what we all know—that the Fed’s tapering last year led to volatility. I infer from that that you thought they could have done it differently.

Dr Broadbent: With the benefit of hindsight at least, yes.

Q83 Mr Ruffley: Thinking of what they could have done differently, could you just set out for us what you will be guarding against when it comes to unwinding? What mistakes, in short, did the US authorities commit that you could now learn from?

Dr Broadbent: In a sense, they were starting from a slightly awkward position in my view because they had made a commitment not to buy a particular quantity of assets but to buy at a particular rate. Coming back to the point you made earlier, Mr Baker, if you imagine that the end stock is what might determine asset prices, if you told someone, “I am going to buy at this rate as opposed to that rate”, that has big implications for the ultimate stock you might be buying; small changes in the rate of flow. They got themselves into a position where they were making judgments about, “Maybe we’ll buy at this rate”, or, “We’ll buy at that rate” and I think that is one of the reasons why markets were so volatile.

That said, even if you are starting from our position, there is the potential for volatility. Even then it may be that you cannot ensure that there will not be any reaction, but to limit volatility you have to be very clear about the circumstances under which you would think about doing this. The MPC has already said something about that. We said in February that we would maintain the current stock at least until interest rates started to rise. We went further in May and we said, as regards active sales of assets, we would not countenance doing those at least until interest rates have reached a level from which, if it were to prove necessary, we could cut interest rates. I think the word we used was “materially”.

Those are weak conditions we have laid out. If we want to say something, I think it would be an advantage as and when we get to the point where we do want to reduce the size of the APF to say something more definite, to introduce guidance about more precisely the conditions under which we would think about doing this, and not to communicate carelessly or whimsically, “Well, this could happen or that could happen”, because that is what happened last summer.

Q84 Mr Ruffley: So no fuzzy guidance—more structured forward guidance.

Dr Broadbent: Exactly, and to be quite disciplined as an institution about what we say and to be as clear and coherent as possible.

Q85 Mr Ruffley: That is helpful. You may or may not have seen Chris Giles; the more I read him the more I see him as a *bête noir* for the Bank. He said something on 7 May that you may have seen in the *The Financial Times*. The allegation is that the Bank is institutionally dovish and I want to read out something that he said because it does contain something quite worrying, if true. I would like you to comment on it. I am quoting from his article: “Bank officials have even been known to dispense with inconvenient evidence altogether. Last August Bank of England staff developed a way of estimating the slack between the number of hours employees actually work and a theoretical normal value. Had officials stuck to their initial methodology, this February’s calculations would have shown no slack left. That would never do, so the old methodology was ditched in favour of something more dovish.” Discuss.

Dr Broadbent: I do not think that is true and I can get back to you on the technicalities of why that is inaccurate.

Q86 Mr Ruffley: Do you think that happened?

Dr Broadbent: No, I don’t think it did. You said some of these things, if true, would be worrying. In my experience a lot of things that journalists say, if true, would be worrying.

Q87 Mr Ruffley: Politicians know that more than deputy governors of the Bank of England.

Dr Broadbent: Quite so. Ultimately, the way you assess whether we are institutionally dovish is to look what happens to inflation over long periods of time. We had high inflation during the period where we were hit by some severe cost shocks. It started in a way in 2003, but the four years until the middle of last year were brutal. There was a judgment made to accommodate part of those and higher inflation in order not to hit up to hard and that is in our remit.

If you look at the long periods of time, we hit inflation targets pretty well on average. That is important, Mr Ruffley, because that is the ultimate test. It was inaccurate what he said—that we changed our methodology simply in order not to take a decision on interest rates. That is not the right way to assess whether someone is dovish or not. You have to look at the decisions relative to what should be taken and the ultimate test is what happens to our primary target, which is inflation. That is the ultimate target. I remind you, currently it is below target.

Q88 Mr Ruffley: For what it is worth, I do not believe you are institutionally dovish, but I want to separate that broad allegation to the second specific point, which is that there was an “old methodology” and that was changed at the beginning of this year.

Dr Broadbent: No. There has been evolution in the way we think about slack. Following some work that was done by other economists, we thought it would be important to look at not just the level of unemployment or indeed total hours worked but to use a useful thing in the labour force survey that asks people not just how many hours they are working but, as a subset, how many hours they would like to work. We have not taken that at face value. My colleague Martin Weale pointed out that it looks like, given what they subsequently do, some of the answers to those questions may be a little bit exaggerated, but I think they are helpful.

We did not ditch some old methodology in order to reach a prior judgment about monetary policy. We are always changing these judgments in order to make them better. What is true, I think—I look at wage growth in support of this—is that although employment has grown rapidly, at least part of that seems to be due to an increase in the supply of labour, not just the demand for it. Certainly that is what you might deduce from looking at wage growth. It is also what you might have deduced—we started doing this before February and, as I said, we were following other economists that pointed this out—if you used the answer in the LFS about how many hours people would like to work. I think at the very least it is hyperbolic, shall we say.

Q89 Mr Ruffley: You refute the charge?

Dr Broadbent: Yes.

Q90 Mr Ruffley: Finally, wearing your FPC hat, I would like to go back to a housing bubble that might occur in the future and statements that the FPC might make if they felt that an asset bubble in the housing market threatened financial stability. Is it the case, from your point of view, that you would want to make a statement about curtailing Help to Buy? Would that be the way you would think about that problem?

Dr Broadbent: As I said earlier, I think it is a very small part of the story and I think that view is reinforced by the data we got recently about the distribution, geographically, of Help to Buy. It is not only uncorrelated with developments in prices, but negatively correlated. It is there and the FPC has a responsibility to think about that. Put it this way: if you got to a point where you were really worried about the rate of growth of credit, I doubt that ending Help to Buy, which has benefited only a very small number of people, would be sufficient to the task.

Q91 Mr Ruffley: I tend to agree with you. Looking at the data outside of London and the south-east, but certainly outside of London, there isn't a housing bubble. Could you just list for us what the metrics are that you would be looking at to determine whether or not we were in bubble conditions in the housing market?

Dr Broadbent: Let me come back to some of the answers I gave earlier because it is very important to remember we are not primarily in the business of identifying and ending bubbles. That is certainly important for the FPC, but it is not what it is for. It is to ensure financial stability and I come back to the answer I gave at the very beginning. If you had a situation where house prices were rising but every single transaction was financed with cash, I would not frankly worry that much about financial stability because there is nothing financial involved in it.

What I worry about is if the recovery in the housing market, which in some areas you say is very strong, encourages an increase in mortgages and, in particular, high loan-to-value, high loan-to-income, i.e. risky, mortgages, that is what matters to financial stability. That, happily, is something that the FPC can do something about, in principle. What it cannot do is say, "I am going to target some particular level of house prices". It is neither possible nor is it the objective of policy. Judging about whether any asset price is overvalued is important, but it is not the be all and end all and it is certainly not the objective of policy.

I said that it matters. How would you go about identifying it? The way that I have tended often to think about it is looking at rental yields and if those are falling very quickly and the spread to risk-free rates is contracting, then I would think, "Maybe this market is getting a bit frothy", but even then what I would also look at is, how much growth in mortgages and risky mortgages is that encouraging or how much is it involving?

Over the last year, aggregate mortgage debt has gone up 1% in nominal terms. There is a risk of acceleration, partly because of rapid price growth in some areas. Therefore it would be sensible to think about what you might do to ensure against that risk in a precautionary manner. At the moment I do not look at price growth nationally, which is 8%

or 9%, and think, “That in itself is what is worrying and I must do something about that”. What matters is debt growth on the back of it.

Mr Ruffley: Very helpful. Thank you.

Q92 Chair: Just a few further questions to wind up, just following up on that. Of course, you are right that the numbers involved in Help to Buy are a very small proportion of the overall increase in housing demand. Do you think that the fact that the Government has a scheme that is encouraging demand has any effect on confidence and, therefore, the appetite to take risk in the housing market?

Dr Broadbent: If you look back to where we were in 2012, we were in a situation where even four years after the peak of the crisis the supply of credit was very weak—not just for businesses and SMEs, but for households as well. Rates of approvals and turnover in the housing market were very low and, because of that, or associated with that, we also had very low levels of residential investment, whether in new homes or home improvements. It was part of the reason for the weak environment.

The big things that changed that were, in my view, FLS domestically and the actions of the European Central Bank and the support they received from the European politicians in the middle of 2012. Facing that weakness, you can understand why the Government might also want to have done something to encourage the supply of credit; but, you are right, the judgment about the wisdom or desirability of that policy depends on circumstances and, given the recovery we have seen in mortgage supply since then, the context is slightly different.

Q93 Chair: Another point you made a moment ago I found very interesting. You said we did in fact accommodate inflation—

Dr Broadbent: To a degree, yes. To a degree.

Chair: —in order to safeguard output. That is not quite how it was explained at the time, was it?

Dr Broadbent: What is true is that there were a great number of these cost increases that happened at quite high frequency and that we could not have forecast. I think it is true in a rather more diffuse sense that you may not have reacted, and this is absolutely the right decision in my view, observing—if you look at what happened—

Q94 Chair: I wanted to stick with the question, which is: this is not the way you explained the policy at the time. The reason I am on that is—

Dr Broadbent: No, I understand that, but I am making the point that, as I remember it, the explanation was we were hit by lots of sudden and unpredictable price increases. That is also true. I think both are true to a degree and people were concerned about the risk that high—

Chair: But this explanation was repudiated at the time.

Dr Broadbent: In my view it did have some weight and I think that is entirely right.

Q95 Chair: I was just going through the same logic in my mind to make sure I've got this clear. You are telling us that the Bank was accommodating inflation at the time and that was an explicit understanding of part of policy. What I am saying is at the time you were explicitly repudiating that explanation to the markets. I just want to link that to a point you made earlier, I think to Steve Baker or maybe to David, about the importance of signalling very clearly how we would handle QE to avoid a "Tapergate" crisis.

Dr Broadbent: The very first speech I gave, Chairman, like many of my speeches, sunk without trace, but it did say that, more or less. It said—and this is entirely orthodox for an inflation target—"If faced with a big cost shock, let's say, for example, a big jump in oil prices, what do you do? Do you immediately tighten monetary policy or do you say, 'We want to smooth out the effects because it has depressive effects on demand, which is part of our objectives, smoothing output, and it has positive effects on inflation and we want to balance those two?'"

Q96 Chair: I don't think it is challenging the policy.

Dr Broadbent: But, as I said, I did communicate that.

Chair: I am only talking about the explanations given for the policy, now against later.

Dr Broadbent: All right. At the moment, happily I do not think we are in an environment where we are forced to make a decision about that trade-off because the cost pressures are very different. If it comes to it then, yes, we ought to be clear.

Q97 Chair: Of course it has some signalling effect for the next set of explanations that we may have at a turning point in the economy if we can look back and see the explanations given were, at the time, not the full explanations that were in the minds of the actors at the time.

Dr Broadbent: People have different views. I more or less spelled that out in the first speech I gave.

Q98 Chair: I want to ask two questions on two further unrelated subjects. You will take responsibility for note production, won't you?

Dr Broadbent: Yes.

Q99 Chair: Do you think there is anything in Ken Rogoff's view that we ought to move to, or at least consider, ending paper money? Is there a role for central bank electronic money?

Dr Broadbent: I think it is a very interesting possibility, possibly a long time away.

Q100 Chair: During your tenure?

Dr Broadbent: The Bank has people who are interested in new payment technologies, who think a great deal about them and it is something people think about. I do not think that is with a view to doing anything in the short term.

Q101 Chair: How do you feel about Bitcoin?

Dr Broadbent: Bitcoin is interesting from that perspective. The payment technology it uses is interesting. I think the idea that it is a proper currency is much less clear. I was taught when I was first taught monetary economics that one of the properties of money is that it should be a store of value. If this thing changes in value by 10% a day then clearly it is not backed by a central bank and so forth. There are different aspects of Bitcoin, some of which are interesting and maybe valuable for payment; others less so.

Chair: I have just one more question, but one of my colleagues is itching to get in now I have mentioned Bitcoin.

Q102 Steve Baker: Has sterling held its value over the last hundred years?

Dr Broadbent: In real terms, yes, mostly. We have seen a nominal decline and we have seen a rapid decline in the nominal value against the dollar often because, at least until 1992, we did not have an inflation target and we had much higher inflation.

Q103 Steve Baker: I am being cheeky because it wasn't the question I meant to ask. The point was about Rogoff. Rogoff said first this point, getting rid of paper money, "It would eliminate the zero band on policy interest rates." Do you think he is suggesting that what you would enable there is for the Bank to set negative rates so that people positively want to spend their money, thereby driving up the velocity of money and price inflation?

Dr Broadbent: You would only want to think about going to a zero pound in exceptional circumstances and we have had those circumstances in many parts of the developed world over the last few years, but it would not be the norm and nor would that be the main reason, I think, for doing this. It would just be because it is a cheaper way of making transactions.

Q104 Steve Baker: Would you be concerned that the public have no way to escape a deliberate policy of seizing their money by seigniorage?

Dr Broadbent: That is why we have an inflation target and the seigniorage numbers in this country are minuscule. That is why we have an inflation target. That is what happened, whether by design or not, in the 1970s. That is precisely why we have had an inflation target and it is a regime that in my opinion has worked very well.

Q105 Chair: Dr Broadbent, the CV you sent us is short but high-powered, I think it would have to be said. There is not much direct hands-on management experience in that CV, not of large groups of people. Do you have that but it is just not spelled out in the CV?

Dr Broadbent: No, I didn't. My last employer is an organisation one of whose principles seems to be to hire people who do not need managing and there are not many managers of large groups of people. As it happens, on the very day I accepted the job at the MPC I would have taken a job that did involve managing large groups of people. However, I did not and prior to that, of course, I was a junior civil servant and an academic where that did not come into it.

Q106 Chair: This will be a new experience for you.

Dr Broadbent: It will. Yes, it will.

Q107 Chair: My last question to you. You will become a member of Court. Have you had a chance to think through what you think about this body and—

Dr Broadbent: Some.

Chair: —whether it needs reform?

Dr Broadbent: I know this is a matter that this Committee has thought about a great deal. As you say, I am no great managerial expert but my experience of what Court has done, certainly in the last two or three years, I think is good. I am talking about what it has done, not its structure. The three reviews it commissioned were serious and important and the Bank has taken them seriously, certainly as regards the MPC. The *Stockton Report* was taken very seriously, and the same is true of Winters and Plenderleith.

Q108 Chair: You would not call it a proper board in the classic sense at all, would you? Do you think it should have one?

Dr Broadbent: I suppose I can see arguments to have one. I am not a great expert on it. What matters ultimately, it seems to me, is whether it is able properly to hold the Executive to account.

Q109 Chair: Do you think it is at the moment?

Dr Broadbent: All I can give you is the evidence since I have been there of these reviews. Those seem to be material and one would hope that the composition of the Court is such

that they are not afraid to commission more reviews as necessary over the future. What that means for the structure—

Q110 Chair: That would have to be described as a heavily qualified “yes”, with a lot of pauses and some aspiration.

Dr Broadbent: It is important. All I can is that Court continues to perform a function and proper oversight of the Executive.

Chair: Thank you very much for coming to see us this afternoon. It has been extremely interesting. We have picked up a lot. I would be very grateful if colleagues remained behind just for a few moments at the end of the session.

