Treasury Committee

Oral evidence: Bank of England inflation report, HC 314

Wednesday 16 September 2015

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Watch the meeting

Members present: Mr Andrew Tyrie (Chair); Mr Steve Baker; Bill Esterson; Helen Goodman; George Kerevan; John Mann; Chris Philp, Mr Jacob Rees-Mogg; Wes Streeting.

Questions 1-90

Witnesses: **Dr Mark Carney**, Governor, **Professor Kristin Forbes**, Member of the Monetary Policy Committee, **Ian McCafferty**, Member of the Monetary Policy Committee, and **Dr Martin Weale**, Monetary Policy Committee, Bank of England, gave evidence.

Q1 **Chair:** Thank you very much for coming to see us this afternoon. It is a slightly later start; that was partly our fault and partly the traffic. The hearing this afternoon has three externals. The Committee felt that we should do something to redress the balance. Over the past five years we have had 44 internals against 34 externals before us, and so this does something to even up the numbers a little. We will be looking at this issue a bit more later on in the Parliament.

I would like to begin, Governor, by asking you about China, and to read out a quote from Willem Buiter who, of course, is a former MPC member, who said: "When forecasting the outlook for growth in China we have the problem that the official GDP data are 'manipulated' to such an extent that the 'true'"—I do not know why he has put "true" and then "real"—"real GDP growth is likely to be at most weakly positively correlated with real GDP growth according to the official data". To translate Willem, he is just saying they make all the numbers up, is he not? What do you feel about that? Do we know what is going on in China?

Dr Carney: There are two questions there, one around the quality of Chinese statistics and then, secondly, what the MPC's view is on the outlook in China and how it affects. Let me start on the former. Certainly, the Chinese statistics are published with remarkable speed and are not subject to revision, and there is a remarkable degree of stability to the underlying statistics.

Q2 **Chair:** And so you are raising a sceptical Governor's eyebrow.

Dr Carney: There is reason to think that there is more underlying volatility in growth in China than in officially measured statistics, recognising we all have challenges with statistics, the United Kingdom included. We do look, as you would expect us to, at a much broader range of indicators to get a sense of underlying activity in China, whether it is electricity, industrial production, imports, commodity imports, auto sales—the hard indicators that shed greater light in terms of underlying momentum in the economy. In broad brush, those indicators have suggested, as have the official indicators suggested, a consistent slowing in the Chinese economy. I would add one point, though. Doing these estimations is an inexact science, particularly because the Chinese economy is shifting from a more investment led economy to a more consumption and service led economy, and so the correlations will not be consistent over time. That is by way of background.

The bigger picture is that the MPC's view has been for some time that the Chinese economy would slow. Our forecast—including our forecast in August—has been below consensus. We have spent a considerable amount of time as a committee on this. We have had joint meetings, for example, last year with the FPC, with outside experts on China. We have had extensive discussions. You will see in the most recent minutes—I think it is reflected appropriately so—that we spent a great deal of time in our last meeting on China. Personally, I was in China last week for a few days meeting with senior officials there. We had a downside skew to our growth forecast in the August inflation report because of China. As we observed in our most recent decision in our minutes—in the monetary policy summary of those minutes, which is something new—we think these downside risks to growth have increased.

Q3 **Chair:** Just to go back to my question, is the reason for you having lower than consensus forecasts on China over that period a consequence directly of the fact that the work you have done based on the data that you feel is reasonably, as you put it, hard data leads you to be somewhat sceptical of the official data?

Dr Carney: Our forecast is our forecast of what the official data will say. It is that the underlying economy is slowing—it shows—at that degree. The errors on Chinese GDP, if you will, have in the past seemed to have gone both ways. In other words, there have been times where the Chinese economy has appeared to grow much faster than the official data. There seems to be some element of smoothing in the data.

Q4 **Chair:** Here too, I can assure you, over the years.

Dr Carney: Here, as you know, we do make a so-called back-cast of data. We forecast what is going to come out, but also what we think will ultimately be post revisions.

Q5 **Chair:** I will have one more go at asking this question. Do you think we should raise a somewhat more sceptical eyebrow about the numbers that come from China than we do for our own economy?

Dr Carney: Yes, there is a likely to be a higher error around the Chinese statistics with respect to the growth numbers. That does not change the reality that the Chinese economy has grown very strongly for a number of years and is still growing. If I may finish here, because it is an important point, our judgment—we have not done an updated forecast—is, as indicated, that there are further downside risks to the Chinese economy, but not in situ at this moment marked downside adjustment to the Chinese forecast. We would not do that until November.

Q6 **Chair:** Mr McCafferty, in July you told us—I am quoting—"There is a balance to be struck in terms of where we pitch policy and I think that balance is quite fine at this stage". Has that altered in the light of the worsening international environment after the 11 August devaluation?

Ian McCafferty: After I spoke to you in July, Chairman, I changed my vote in favour of a rate rise from no change. That would otherwise suggest that I think the balance has changed not in the direction of the downside because of China, but I worry about the domestic risks that we face in terms of inflation at the two-year horizon. The international risks have moved more to the downside; I agree with what was said in the minutes and the August inflation report about the international risks. There is a very interesting question—we have looked at it in some detail—about the extent that the movements in the Chinese stock market, for example, will have a knock-on effect on the UK economy. I think the answer to that is it is limited, but to the extent that the Chinese economy slows down more broadly, that will have an effect. Again, in terms of the estimates that we have from the direct trade effects, that is also relatively limited. I would be more worried were I to see evidence of further contagion though other means, particularly were we to understand that our banking system was heavily exposed to China, which we are reassured by the FPC is not the case, or were we to see a downside to consumer and business confidence in the UK as a result of the events that we have recently seen in China—again, there is no evidence of that at this stage. I think we can say that the downside risks from emerging markets, and in particular China, have increased, but the impact on the UK I still think is limited and contained, whereas the data that I have seen over the course of the summer suggests that some of those upside risks to inflation on a two-year horizon have, if anything, increased slightly further.

Q7 **Chair:** Therefore, on balance, do you feel that you are moving in a more hawkish or a less hawkish direction?

Ian McCafferty: I have changed my vote from no change to an increase, so I am more worried about inflation in the UK now than I was three months ago.

Q8 **Chair:** Yes, but on the basis of the domestic pull being stronger than the international relief, so to speak.

Ian McCafferty: Yes. Adding all of the things together on balance, yes.

Q9 **Chair:** Dr Weale, for six months last year you were a hawk, were you not? Why have you not joined Mr McCafferty in voting to raise rates?

Dr Weale: I myself do not find the label of a hawk terribly useful.

Chair: You have been in favour of somewhat tighter monetary policy.

Dr Weale: I was voting in favour of an increase for just under six months. My view of things is very similar to that of Mr McCafferty. I suppose three things have really made me not feel that at this stage it is yet appropriate to vote for an increase in bank rates. One has been developments in China, but I share the Governor's sense that that is an increase in risk rather than as yet some sort of clear downside effect that needs to be embedded in our forecast.

Secondly, there has been a further downturn in raw material prices. Just as I had said that the earlier fall in oil prices last year gave us a breathing space—that was the reason why I stopped voting for an increase—this further fall in oil and raw material prices has probably given us another breathing space.

The third factor is quite possibly going to be rather more important than what has happened in China: what should we make of what is happening in productivity in the economy at the moment? For a long time we have puzzled over why productivity was so weak. The most recent figures suggest that that weakness has suddenly come to an end, and there is a question, which cannot be answered with any certainty, of how far the second quarter strength we have seen in productivity will last. Is it too good to last? Is it too good to be true, or have the unidentified factors that had been holding back productivity melted away?

Q10 **Chair:** The oil price effect you are describing and are saying is giving breathing space is a relative price effect, is it not, unless you think that it is going to have a knock-on effect into inflationary expectations in the medium term?

Dr Weale: I see it as a relative price effect, certainly. I suppose I also bear in mind that not only my experience of the period of above-target inflation but also more general statistical analysis suggests that apparently independent inflation shocks tend to come, like buses, more than one at a time. That is not something I would necessary give a great deal of weight to, but it is something that makes me a bit more cautious.

Q11 **Wes Streeting:** Can I just begin with a slight follow-up to the Chair's question? This is directed, for this moment, to anyone but the Governor. No offence, Governor. To what extent are you satisfied, as members of the MPC, with the quality of the Bank's information and analysis of the global economy generally but the Chinese economy specifically? Professor Forbes, you might want to go first.

Professor Forbes: I have been at the Bank about a year and I have very impressed with the quality of the analysis we have been given. We have a pre-MPC day, where we have a series of presentations by the staff on the global economy, financial markets, prices in the UK and demand in the UK. Every time we go to that meeting, I leave impressed with the amount of data and information they have given to us in a very short amount of time, very succinctly, starting from a high level of information and building on that.

In terms of the global economy, there have been a lot of surprises, and many are very hard to predict and very hard to forecast. I will also say I have been impressed with the analysis the Bank has done. We, in our forecast, included a weaker outlook for China than consensus forecast and than the IMF, and that is proving to play out. At this point, I can only say complimentary things about the analysis I have seen so far in the year I have been here.

Dr Weale: Could I just add to that, although not with reference to China, that both Ian and I thought that we would like to know more about what was going on in subcontinental European countries, and Bank staff have now responded to that, which is very helpful.

Ian McCafferty: I would agree with what both Kristin and Martin have said. I will simply say that with the internal restructuring that the Bank has undergone over the last year and a half we have placed greater emphasis on the international economy. We now have an international economy division, with greater resources. I would second what my colleagues say about the quality of the research that we receive.

Q12 **Wes Streeting:** Notwithstanding the difficulties that the Chairman alluded to on China specifically.

Ian McCafferty: Everybody faces the same difficulties in terms of interpreting the Chinese data, and I agree with what the Governor has said about that data. We have difficulties interpreting data in a number of economies; it is a myth to believe that somehow statistics about an economy can be perfect. There are always going to be interpretational issues, but, within that constraint, we get very good analysis from the Bank staff.

Q13 **Wes Streeting:** I want to stick more generally with China, but to follow-up on something you just said, Dr Weale, could you elaborate a bit further in terms of the information that you required on the European economies? What is it you had felt that the Bank was not provided previously that you required? Are you satisfied that that is being provided to the full extent now?

Dr Weale: I felt that the Bank analysis tended to focus on the euro area as a single bloc. We read in the press about things that are happening in particular countries, not things that are happening in the euro area as a whole. That made it, at least to me, helpful to have small-form analysis and presentation of data, particularly for the large countries in the euro area.

Q14 **Wes Streeting:** Did the Bank have its eye appropriately and effectively on Greece?

Dr Weale: Very much, yes.

Q15 **Wes Streeting:** Going back to China, Governor, to what extent do you think the devaluation of the Chinese currency on 11 August was a policy misstep by the Chinese authorities?

Dr Carney: The Chinese authorities are grappling with a series of policy challenges, the most important of which is the rebalancing of growth from externally oriented growth—investment-led growth—towards domestic-consumption-led growth. That is a process that will take many years. It requires a series of reforms. It requires changes in relative prices. In concert with that, they are grappling with a debt overhang that is the consequence of a very large stimulus in response to the global financial crisis, a stimulus that helped maintain global demand at the time, and certainly demand in China. One of the consequences of that, though, was that a very large shadow banking sector grew up—a parallel financial sector grew up—and one of the sharpest accumulations of debt in any major economy in recent history. They have the challenge now of working through that debt, which is not all in the formal financial sector, which makes it harder to restructure it if restructuring is indeed necessary. There is the slowing of the economy. One way to look at the slowing of the Chinese economy is to look at it in nominal terms, when you think about it from a debt perspective. The Chinese economy was growing around 20% in the last two years prior to the crisis in nominal terms; it is now growing in the range of 6% to 7% in nominal terms. You have a combination of a very sharp increase in debt and a much lower growth in income in aggregate in the economy, which, just by definition, makes it more difficult to work out. The challenges in the financial sector mean that there are more challenges with the transmission of monetary policy. Certainly, the steps that the People's Bank has taken in recent months have provided additional stimulus to the economy, but it works less effectively when there is a debt overhang and when banks are concerned about rising NPLs.

They have those various challenges. On top of that, they have an ongoing financial reform challenge, which can help with the ultimate rebalancing of the economy but brings its own stresses and strains as it goes along. The currency plays into all of these aspects. The currency is a relative price, so it sends a signal about domestic resources versus resources for export. More liberalisation of the currency is helpful, as Professor Forbes can explain in great detail, in terms of the liberalisation of the domestic financial market. The trick is managing capital account liberalisation at the same time—and at the same time as they are trying to internationalise use of the currency.

In that context, with those pressures, the decision was taken by the Chinese authorities to, in their words, move to a more "market-determined" exchange rate. They certainly, in the short term, moved the exchange rate to levels more consistent with where the market was trading, because the market was trading at the depreciated end of the band, if I can say it that way, and so they re-fixed it there. Certainly, there are indications that the intent to provide greater flexibility was not an intent to provide a substantial depreciation of the currency. The combination of the difficulties in the stock market, uncertainty about their policy intent, the underlying economic forces and uncertainty about Chinese growth prospects have all combined to put some pressure on the level of the currency. The net consequence of that has been a reasonably substantial intervention by Chinese authorities to maintain the peg and provide some stability.

If you put all of that together, this is a process of reform that is ongoing. There will be stops and starts as they move forward. I will say that in the discussions that I have had over the last two weeks with the most senior Chinese authorities, whether it is at the G20 or in Beijing last week, I was left in no doubt in terms of the intent to continue with the pace of financial reform, if not accelerate it, given these circumstances. That is welcome.

Q16 **Wes Streeting:** Overall, have the interventions taken so far been helpful or have they been a hindrance to achieving a positive outcome?

Dr Carney: In the very short term, some of the interventions have created a bit of uncertainty about the direction of policy and the intent of policy. That has hindered some of the natural market adjustments that one would expect and the Chinese authorities would ultimately welcome. As I just said, the overall direction of policy continues to be towards further liberalisation, including in the financial sector, and that will be necessary. An important point is that what is good for the medium term is not necessarily positive for the short term. Some of this liberalisation will act to slow growth at a time when growth has already been slowing. The consequence of that, as Chinese authorities have made public—I just referenced the Prime Minister's remarks of last week—is that it may be appropriate to provide some fiscal stimulus in concert with further financial liberalisation.

Q17 **Wes Streeting:** Based on the conversations you have had with the Chinese authorities—you mentioned that you were there very recently—what, in terms of the foreseeable future for us, do we need to be thinking about in terms of the impact on the broader global economy, Britain's economy specifically and any policy implications for the Bank or for the Government?

Dr Carney**:** Mr McCafferty began this answer. We look at it first in terms of the impact of a slowing Chinese economy on the UK. Let me begin with a model-based analysis of that. We have looked at—and we looked at it in advance of our last decision—what if Chinese growth is 3% lower at the end of the forecast period, so accumulates to 3% less growth? What is the impact on the UK through direct trade channels and indirect trade channels, both of which would slow our economy? We would get something back over time through a terms-of-trade effect—lower commodity prices and higher real incomes here would help—and then we have to model through potential financial market effects.

The sum of all that is that 3% off Chinese growth is about 0.3% off global growth and about 0.1% off the level of UK growth. That is quite a modest number. However, as Mr McCafferty said, there could be nonlinear effects—there could be deeper financial contagion in financial markets as a whole and there could be confidence effects. You have to take model analysis with a grain of salt. The fact is the Chinese economy has steadily become more important and there is a multiplier effect through global trade. Those elasticities—those variables—will have shifted with time. That is why we have quite robust debate and we do not just rely on one analysis.

What should we do here in the UK? From a monetary policy perspective, on the margin, Chinese developments increase downside risk, as we have all noted. It may well be the case that it further lowers the global growth outlook, including for the UK. That is certainly a possibility. In terms of the outlook for growth in inflation in this country, we have two competing forces: we have a weak global economy—China is adding to that—and we have quite a robust domestic economy. We have to balance the two.

The very last point I will make is a non-monetary point. In terms of broader policy and policy towards China, the process of financial liberalisation and reform in China is an area that the UK can help with greatly, which is one of the reasons why there is an economic and financial dialogue between our two countries.

Q18 **Chris Philp:** Governor, continuing on the theme of the Chinese currency, which Wes Streeting started on a few minutes ago, do you interpret the 3% devaluation as the start of a currency war or as the start of a series of competitive devaluations globally?

Dr Carney: I would not use those terms to describe it. Chinese authorities are working through the process of having a more market-determined exchange rate. One of the realities in China is that the vast majority of people, institutions, institutional investors and corporations are disproportionately exposed to China because of historical capital controls, and so there is a natural desire to move capital offshore and to invest abroad, whether it is in portfolio investment or foreign direct investment. As China liberalises, those flows will begin to move.

The converse—to develop a bit what we were just talking about—should be that they do have a very large stock of debt in China that needs to be worked through and restructured. While they have a large pool of savings, as they develop their financial system, it would be in their interest for more institutional capital to come into that economy. From a portfolio-flow perspective, you have these competing forces on the level of the currency.

The next point is in terms of the overall valuation of the currency. We do not have an official Bank of England view on the fair effective exchange rate of the renminbi, but the IMF's view is that it is roughly fairly valued at current levels. The undervaluation that had been present for the renminbi for most of the last decade, in the view of the IMF and many others, has largely gone away, as a consequence of quite a sharp real appreciation over the course of the last several years as it has followed up with the US dollar.

Q19 **Chris Philp:** Even though it still has a gigantic trade surplus with the rest of the world.

Dr Carney: Relative to its economy, I would not say it is gigantic. It runs a trade surplus. Part of the reason it has a trade surplus, though, is one of its fundamental challenges, which is that it has quite modest consumption and quite a high domestic savings rate. That is a product of many things. It is a product of the structure of the financial sector; it is a product of the absence of a safety net. There is a variety of things that need to change, which the Chinese authorities recognise need to change and are changing.

To go back to the core of your first question, my point is that, no, we would not view the Chinese move as the start of some broader process of an explicit exchange-rate target. All of that said, there are relatively few economies in the world that are growing above their trend rate. The UK is one of them; the US is another. Of the major economies, you could probably roll India into that equation. You are a bit harder pressed, unless you really revise down your views of trend, to find one on the continent. That brings the prospect of divergent stances on monetary policy and exchange-rate adjustment, which comes into the equation and then we have to take that into account in appropriately calibrating monetary policy.

Q20 **Chris Philp:** Thinking more generally about emerging markets, we have focused on China but emerging market weakness is more widespread than that. I would be interested to hear, perhaps, from Mr McCafferty whether you are concerned that wider emerging market weakness beyond China may be a drag on the global economy and may, therefore, keep inflation expectations low going forward.

Ian McCafferty: In terms of the weakness of a number of emerging markets, the Governor mentioned the modelling we had done. We had looked at the weakness in emerging markets as a result of the slowdown in China within our modelling. There are also a number of obvious sufferers from the very low oil prices. Commodity exporters are also seeing their growth rates slowing and some have already moved into recession. Clearly, that is part of the international downside risk that we have added to our forecast. In terms of the UK, the further fall that we have seen in oil prices in the course of the last few weeks, relative to both May and August, clearly prolongs the period of very low inflation by a few months. Beyond that, as the Chairman himself said, this is a price level effect and, over the course of the horizon we are looking at in terms of domestic inflation, should fall out of the equation. From that point of view, there is a balance to be struck in respect of the very low rates of inflation we see now, which are being driven primarily by low commodity prices, low oil prices and low food prices. As we have said on a number of occasions, about three quarters of the undershoot to the 2% inflation target is due to those factors alone. Those will fade over time, even allowing for the very recent further weakness in oil prices, and thereafter we should be more focused on domestic inflationary pressures.

Q21 **Chris Philp:** Thinking again for a moment about currencies and their implications, clearly UK sterling has appreciated significantly over the last two or three years, which has helped in terms of keeping inflation down but has made exporting significantly more difficult. Do you have any views on that and whether our own currency is trading at an appropriate value?

Dr Carney: Sterling's persistent strength is an important factor in terms of the evolution of prices and the pressures on inflation, in my view, including over the medium-term horizon. That is not because pass-through of those exchange-rate changes is slow for the import prices per se. Professor Forbes has done some recent work on this as well. That is relatively quick, but, as it works through the supply chain, ultimately it filters through to end-consumer prices and that happens to show up over our forecast horizon. The consequence of all that is that in terms of overall costs in the economy we are seeing a firming of domestic costs—you can see that, for example, in the pick-up in wages, although a little less so in unit-labour costs at the moment—and that is welcome, but we have this imported disinflation, if you will, not just because of weaker prices abroad and commodity prices but also because of the strength of sterling. We look at it more from that perspective. There is no question in terms of overall resource utilisation in the economy that a stronger currency puts more pressure on our exporters—we hear that from exporters as we go around the country—and that has an impact for the uses of resources in this economy. As a whole, though, the economy has been growing at a faster rate, at least in my judgement, than what its trend is. On balance, while there will be little wiggles around it, we expect that to continue over the course of our forecast. Despite this pressure from sterling on our exporters, we see the economy using up the remaining slack really within the course of the next year and then going into a position of some excess demand by the end of the forecast.

Q22 **Chris Philp:** My final question is more of an FPC question. It is a follow-up on a conversation we had about three months ago and a conversation we had with the Chancellor at this Committee in July. There was some discussion about bringing buy-to-let mortgages into the regulatory net of the FPC and the Chancellor suggested he was going to be imminently writing to you about that. I wondered, first, whether you had received that communication or whether you had any further news for the Committee on any plans to start regulating buy-to-let mortgages.

Dr Carney: Imminence is in the eye of the beholder, I guess. I have not yet received the correspondence from the Chancellor, but we have spoken about the issue and it is very much on the agenda of the FPC. We are in a series of FPC meetings for this round of the FPC at the moment; we have had two already this week and we have another one on Friday. Buy-to-let is one of the issues. We are in dialogue around the issue and the FPC will form its final opinion on that by the end of the year.

Chair: We will be coming back to you with an FPC hat on, on that subject, I feel sure.

Dr Carney: I look forward to it.

Q23 **Mr Jacob Rees-Mogg:** As we have been on emerging markets, I would just like to reiterate my declaration of interests. I am chairman of an emerging markets investment management company.

I want to follow on from the questions on sterling. Professor Forbes, in your excellent report, which was much enjoyed through its references to Odysseus—it should be encouraged to become Bank policy always to involve Greek mythology in reports—you mentioned, and the Governor alluded to this, that “recent evidence suggests that the pass-through [to inflation] from sterling’s recent appreciation has been substantive, but may have been less than in the past”. Why do you think it is less than in the past? Do you think that will continue?

Professor Forbes: Thank you for asking that question. It is always a pleasure to talk about research I have been working on. Just to be clear, this is some independent research I have been doing with some people at the Bank but not official Bank views or changes to our forecasting models. The research that we have been doing has basically tried to answer a big puzzle that I have been challenged with while at the Bank, which is that pass-through seems to change over time. Traditionally, most banks and most people forecasting inflation assume that the rate of pass-through is constant over time, and that is practical to do our models. What we have noticed is it has changed quite dramatically in the UK. During or after the crisis, there was much greater pass-through than we had previously seen. What I mean by that is that, given the exchange rate depreciation that happened after the crisis, there was a much bigger effect on prices and inflation than the standard models predicted. We updated our models to assume a higher degree of pass-through—a higher effect of exchange-rate movements on inflation—but recently we have seen some evidence that there is less pass-through than we had seen during the crisis. More specifically, we have seen that despite the rather strong appreciation in sterling—about 17% so far since its trough in March 2013—there has been much less effect on import prices than our current models had expected to see. Import prices have not fallen by as much as one might expect given sterling’s strength. That has pushed us to try to think through why.

What I have done in some of this work is come up with one potential explanation for why this might occur. The explanation, boiling down a lot of technical work, is that when thinking about how an exchange-rate movement affects prices we probably need to take a step back and say, “Why did the exchange rate move?” The exchange rate can move for many different reasons. It could move because of stronger demand in the UK, which is what is happening today. It could move because of changes in productivity growth. It could move because of changes in global demand or global shocks or global events. If you take that step back and think about why the exchange rate moved, you find that different reasons why the exchange rate moved might have different effects, in turn, on prices and inflation, which makes sense when you think about how companies could respond. For example, recently, even though sterling has appreciated quite a bit, which has caused import prices to fall—there still are substantial pass-through effects; I do not want to make it sound like it has all gone away, but it is smaller than in the past—traditionally, that might put pressure on UK companies to reduce their prices and act on more of a drag on inflation, but this time around a major reason why the exchange rate has strengthened is strong demand in the UK. UK companies see cheaper imports, but, since demand in the UK has been so strong, there is less pressure on them in turn to lower their prices because of cheaper imports in the past. That could explain why there is less pass-through today, for example.

Q24 **Mr Jacob Rees-Mogg:** Do you think that to some extent the pass-through is delayed when the currency is appreciating as opposed to when it is falling, in that, if you are exporting to the UK and you are suddenly losing money you have to put your price up, whereas you do not necessarily have to cut it quite so quickly—you may have a little bit of time—and, therefore, these effects will still be there but may simply come through over a longer time period?

Professor Forbes: There are some interesting questions there about the length of pass-through. Traditionally, import prices adjust quite quickly, and we have not seen any evidence that has changed, but there are a number of factors that could influence how long that second stage of pass-through, where changes in import prices feed through into the overall price level, takes. The factors you mention could be some; it could also just be confidence in monetary policy, expectations for inflation—a whole set of variables. It is that second stage I do not think we have a good grasp of. I have not seen any evidence to suggest that the effects go in opposite directions, as you have suggested, but it is certainly plausible.

Dr Carney: If I could very briefly cut in on this, there is some evidence—not for the UK but for the US—that there is more pass-through in difficult periods. This is micro-data; you go down to the level of the firm. A firm that is under pressure that is exporting to the US is more likely to re-price its dollar price because it is effectively cannibalising its customer base; it needs cash flow so much that it re-prices at that point. This is work out of Jackson Hole that came through. We have not done a similar analysis for the UK and I would not say we are in that sort of extreme situation right now.

That said, one of the things that was surprising during the recession here, when sterling depreciated, was that pass-through was surprising high at that point and, given the global recession, there could be an element of that type of local pricing effect, because of financial distress of underlying firms. It all goes to underscore Professor Forbes' first point, which is that pass-through tends to vary over time and we have to be conscious, particularly given the scale of the moves in sterling, of updating our perspective on that. We are committed to doing so in the November inflation report, because we have a fair bit of work on it right now.

Q25 **Mr Jacob Rees-Mogg:** Professor Forbes, does it depend to any degree on the balance between the changes in the various currencies? That is to say, the recent rise of sterling has been less against the dollar than other currencies. The dollar is the key currency for setting a whole swathe of international prices, whereas in 2008-09, when the pound was falling, it fell very heavily against the dollar. Do you think that has any effect?

Professor Forbes: It certainly could. That is one of a set of issues that a number of people at the Bank are looking at right now. Building on that, why it is top of mind is—you are right—from March 2013 until about last summer, sterling appreciated against everyone, so that was not as big of an issue, but since last summer sterling has appreciated quite a bit against the euro but weakened against the dollar. A lot of international pricing is in dollars, yet at the same time a large share of UK imports are from the EU and the eurozone, especially for food. There is some evidence there is faster pass-through in food and items such as that. You might get some different types of pass-through based on the different movements against different currencies and the different types of goods we import from these different regions. That is certainly something we are looking at right now.

Dr Carney: Yes, I absolutely agree with that. One of the challenges, though, is if you invoice in your own currency—if imports are invoiced in sterling—then there tends to be less pass-through. Unfortunately, most invoicing is in one of the two other major currencies, US dollars or euros. I suspect what we will find is that, yes, it matters, but we still get a fair bit of pass-through in import costs. Where it is different is in the US. Most US imports are invoiced in US dollars and there tends not to be a re-pricing of those imports; they tend to price to the market. The US tends to get less pass-through than an open economy like the United Kingdom.

Q26 **Mr Jacob Rees-Mogg:** Can I move on to the current account deficit, which we touched in the last evidence session? 6.5% of GDP, a record high for the United Kingdom; income flows not coming in; the currency rising. Is this an issue for the MPC? How is monetary policy looking at this, to the extent it is? Is sterling going to become a determinant of monetary policy to any extent, considering the very unhappy experience the UK has had of doing that in the past?

Dr Carney: It is an issue for monetary policy—or it certainly is an issue for the MPC. In the run-up to our most recent meeting, we had a series of analyses around the issues related to the current account, both from a monetary and a financial-stability perspective. We had joint meetings between the MPC and the FPC on precisely this issue to try to understand the dynamics of the current account, how big the risks were and the relative roles of monetary policy and macroprudential policy, the province of the FPC, in the context of a given fiscal policy—a fiscal consolidation that is underway. As the minutes show, there was a discussion of the current account and its potential implications for monetary policy. Effectively, the conclusion of that discussion was, if I may speak out of control of colleagues, that it did not change the stance of monetary policy at this stage. The concerns about the current account are, at this stage, medium-term financial stability concerns. Without question, it means a need for heightened vigilance about what is driving the current account. What is the savings imbalance that is helping to drive this? It is largely fiscal at this stage. There is a plan to deal with that. Others can judge it, but there is a plan to deal with that. It means the FPC has to be particularly sensitive to potential build-up in household debt, because it could help trigger challenges in the current account.

There is another medium-term issue, though, that we should all be conscious of, which is that one of the big drivers of the current account deficit is a sharp fall in net income from abroad—three percentage points plus of that 6.25%—largely, probably, driven by poorer returns in places like Europe, not surprisingly, on net foreign assets that UK residents have. Two things can happen here. One is that the returns on those assets can gradually return to historical levels because of reform or restructuring in Europe and a brave new dawn and all that—or UK holders of those assets can begin to adjust their consumption to a more consistent future income stream from abroad. The former is the good scenario; the latter is an adjustment scenario, which could take place smoothly over time or could be more abrupt, depending on events, in which case there would need to be some sort of policy response.

Broad brush, at least my personal opinion is that, given the scale of the current-account deficit, taking the fiscal policy as given, which is a stance of consolidation, macroprudential vigilance, combined with monetary policy that is continuing to grow the economy above trend to use up slack, is appropriate.

Q27 **Chair:** Governor, have you had a substantial discussion with the Chancellor about exchange rate policy, which is of course his domain, since you became Governor, supported by documents?

Dr Carney: In that case, no.

Chair: It is good to know we always get clear and honest replies from you.

Dr Carney: Let me amend that. In my role as Chair of the Financial Policy Committee, I have had a substantive discussion with the Chancellor about the current account in the course of the last two weeks, which will be reflected in the record. We have a responsibility, following our financial stability reports, to have these discussions, and we did.

Q28 **Chair:** I am just asking whether you have had a specific discussion since you became Governor with the Chancellor about this huge area of policy that remains with the Chancellor and that has a huge bearing on what we are talking about this afternoon.

Dr Carney: Two things. On the policy aspect here, there are a variety of policies that will influence the current account deficit.

Q29 **Chair:** It is really a relatively straightforward question, this one, Governor. Either there has been—

Dr Carney: Have we talked about the current account? The answer is yes.

Chair: Of course, but that was not the question.

Dr Carney: Then it is not that straightforward.

Q30 **Chair:** Have you had a freestanding meeting set up specifically to discuss the exchange rate with the Chancellor since you became Governor?

Dr Carney: Have we had a freestanding discussion of the exchange rate with the Chancellor? No. Does the exchange rate come up in the context of other discussions? Yes, obviously. What I am slightly uneasy with, or uncertain of, is that earlier in your question you suggested that exchange rate policy was the policy of the Chancellor. The UK has been committed to a floating exchange rate. It is an integral part of monetary policy and while, in extremis, certainly decisions could be taken, and the reserves are under the control of the Chancellor, appropriately, so decisions could be taken—

Q31 **Chair:** You will not be taking any early decisions to join the euro, will you, Dr Carney?

Dr Carney: I cannot possibly imagine that scenario.

Q32 **Bill Esterson:** Professor Forbes, I enjoyed your report to us. Thank you very much. To go back to what you were saying earlier about the exchange rate, can you just clarify something for me? Are you saying that, in relative terms, there is a lower than, perhaps, historical impact on inflation of the recent and predicted future movements in the exchange rate? Would that be a fair characterisation?

Professor Forbes: Let me clarify exactly what my work has shown. Again, this is all preliminary and in the early stages. What it has shown is that you really need to think about why the exchange rate moved. The reasons behind the big exchange rate movement after the crisis could explain higher pass-through during the crisis. The reasons why the exchange rate has moved recently could explain somewhat lower levels of pass-through that we have seen recently. Going forward, that does not mean that will continue to apply. Who knows where the exchange rate is going—as an academic, I never predict where the exchange rate is going—but if it did appreciate further, it may have more or less pass-through. We do not know. We would have to look at the underlying reasons why the exchange rate is moving and then estimate how much pass-through we expect at that time. I do not want to be seen as saying there will always be lower pass-through; this just could explain what we have seen recently.

Q33 **Bill Esterson:** As you noted earlier, it has fallen back in the last few weeks. If that continues to happen, what would be your prediction about the impact on prices?

Professor Forbes: We would have to look at exactly why it has fallen back and how much. To put the recent depreciation in context, though, sterling has appreciated about 17% since its trough. It has appreciated 4% since the May inflation report and it has depreciated 2% since August. When we think about the effects of pass-through, most of these effects are calculated over several years—some models say over three to five—so it is not terribly useful: up 1% or down 1%, in terms of the effects on monetary policy, would be very minor.

Dr Carney: In the August inflation report, the recent experience of lower than assumed pass-through was incorporated in the inflation forecast. That is noted in the report. We have had some of this experience. Professor Forbes is making a broader point about a broader set of issues, but, at least in terms of the experience that has been a bit less than one would have expected, we have incorporated that in the forecast.

Q34 **Bill Esterson:** Mr McCafferty, earlier you talked about the risks of domestic inflation. Can you say what you think those are?

Ian McCafferty: Over the course of the August forecast, we have inflation picking up quite smartly through 2016 as some of the short-term effects of low oil and commodity prices fall out. From that point on, inflation will be more determined by underlying domestic factors—primarily unit-labour costs. What we have seen over the course of the last few months, also including this morning’s data from the ONS, is a relatively sharp pick-up in wages. As the Governor says, we need a sharp pick-up from the very low level of wages that we have had in the past, but I do believe that, when combined with the evidence that I see of a tightening in the labour market and some suggestion that there are growing frictions in terms of placing individuals into new jobs starting to appear as we approach full employment, over the course of 2016 and 2017, the risks are that wages will pick up a little faster than our central forecast embedded in the August report, such that we would see a slightly greater inflation overshoot by early 2017 than the central projection in the forecast.

Q35 **Bill Esterson:** Even though we have zero inflation at the moment, your view is that these risks are still too great.

Ian McCafferty: Yes. I think it is fair to say that none of us believes that that low level of inflation, currently zero, is going to last. We are looking forward over a year and two years. By then, we are very confident that inflation will be back to target, and I have some worries that by the end of the forecast period we will be slightly above that target.

Q36 **Bill Esterson:** One of the factors would be the weakness in the global economy. How big a factor is that in your analysis?

Ian McCafferty: As I have said, the global economy—we have talked about this at some length already—provides some downside risks particularly to growth in the United Kingdom. Were we to see growth in the United Kingdom slow markedly, clearly the upward pressures on wages and inflation would diminish. In terms of the modelling we have done of the impact of slowing growth in China and the emerging markets, as the Governor has said, that would reduce growth in the UK by about 0.1% per annum over each of the next three years. That would still leave us growing in line with or perhaps slightly above our underlying trend rate and, as a result, we would still see some further pick-up in wages from where we are today.

Q37 **Bill Esterson:** Simon Wren-Lewis is arguing for a rate cut at this stage. He favours the case for taking the risk of higher inflation as the lesser of two evils, believing that stimulating the economy is more important than taking the risk of deflation.

Ian McCafferty: In terms of the recent past, what I have learnt from the recent period of zero inflation is that it is extremely difficult to unseat medium-term inflation expectations on the part of businesses and individuals. One of the reasons that I stayed my hand in terms of voting for a rate increase last autumn alongside Dr Weale was the fear that the low rates of inflation that we were expecting to see this year as a result of the collapse in oil prices would have a psychological impact on price setting and wage setting in the economy. That risk has not materialised; inflation expectations remain very well anchored, and I think that is going to remain the case. From that point of view, the risks of a persistent deflation—in the sense that I believe you mean it, which is more than simply zero inflation over the very short term as a result of weak commodity prices—as a result of changing inflation expectations are now very low indeed.

Dr Weale: Could I add a point there, please? If you look at the United Kingdom, even during the relatively few periods of fairly rapid falling prices—say, the early 1920s—there is, as far as I know, not the evidence that suggests that there was a sustained deflationary cycle built around expectations. There was a fall in the price level with the return to the gold standard—that was policy-induced—though things then became more stable. I think it is fair to say we have not really had the sort of expectations-induced deflation that people seem to be concerned about.

Q38 **Bill Esterson:** Governor, in answer to the Chair's questions at the start, you talked about the downside risk to growth having intensified. That is, presumably, the analysis that outweighs what we have just heard from Mr McCafferty in particular.

Dr Carney: Two things, if I may. I said "intensified" and then I amended it to "increased", to be consistent with what we said in our monetary policy summary. Speaking for the committee, they used the word "increased", not "intensified", and I would share that.

There are risks. There are risks that were there before. They have increased. They will require a policy response in a number of emerging markets, most particularly China, and there are always execution risks around that, so we will have to see how things develop. Speaking for myself personally, it is not that something happened in China in August and that determined a vote in September. It was certainly relevant to the vote—it certainly has to be taken into account—but from my perspective, if you look at our forecast at the core of this inflation report, one of the assumptions in it is the market rate path, which is a gently rising pace of rate increases that begins in the second quarter of 2016. In the start of the third quarter of 2015, if the world is looking more or less like that forecast and there is nothing materially new that would bring upside risk, then it would be consistent with that forecast not to raise rates at that point.

Q39 **Bill Esterson:** You are expecting to be supporting a rate rise.

Dr Carney: Well, that is broad brush. That is a consensus forecast. That is the best collective judgement of the MPC. Individuals will have different views about the likelihood of that forecast coming to pass, the relative risks, the timing and the right path of rate increases. What I have said on a number of occasions and have recently repeated—and I will repeat it today—is that my view is that, if the economy follows the path broadly consistent with this forecast, then the decision, at least for me, will come into sharper relief around the turn of the year.

Again, that is the decision. That is not a pre-commitment to do anything in particular, but, at that point, if we have seen a year and a half of the economy growing above trend, if we are seeing unit-labour costs start to move up to the high ones and into the twos and wage growth moving above 3%, consistent with the unit-labour cost performance, and if we are seeing core inflation—which is taking into account a number factors, but, importantly, the important pass-through issues we have been discussing—certainly firming from the current 1% level and moving towards the upper end of a band, then the decision comes, as I say, into sharper relief and it may be appropriate to begin to withdraw stimulus at that point.

A lot can happen between now and then. Let us hope a lot more positive than negative happens between now and then. That can change. There will inevitably be shocks and things will move around. We will provide the guidance as appropriate. To hammer the point, if you were on the margin—I am not speaking for anyone in particular—of whether to have raised rates in August and you get to the September meeting and events in China that increased downside risk could push you away from voting to raise rates, but if you were not thinking that that was the appropriate strategy, China is an interesting development but not a determinant.

Q40 **Bill Esterson:** I will not pursue—we did this last time—the point about whether deflation or inflation is a greater risk. I will not go into that again.

Can I ask Professor Forbes and you, Governor, about bank lending, in particular to micro businesses and people who are self-employed? It was something you both touched on it your reports, that that was a sector where there is still great concern. What are your comments on that?

Dr Carney: What we are seeing in terms of lending to small and medium-sized enterprises is there has been a steady improvement in credit conditions and the pricing and availability of credit—granted, it has been a steady improvement from quite constrained levels even as of a few years ago—and, in terms of the flows, they are picking up at a reasonable pace. It has been an issue; it is much less of an issue. It is part of a broader improvement in financial conditions. In fact, when we look at financial conditions as a whole in the UK, over the course of the last several years there has been a steady improvement in financial conditions, including now for small- and medium-sized enterprises.

To put some context around events in China, yes, there was an increase in corporate spreads and the equity market bore some brunt so there was a tightening of financial conditions, but, relative to the broad improvement over the course of several years, it is a modest adjustment from there.

Professor Forbes: I would second most of that but add a little more colour. Credit conditions have improved for all companies. It is hard to find many large and medium-sized companies that seem very credit constrained today. The last group where there are still some who may have trouble accessing credit is smaller companies. That is the traditional cycle you see across countries during recoveries: the last to get access to credit tend to be the smaller companies. Some of the smaller companies I have met in some of my agency visits have talked about other sources of finance, which is also an interesting angle—relying less on banks and finding other ways to access credit. It is unclear how much of that will persist and how much of that is choice because they do not have easy access to banks.

One question that I have struggled with that I do not know the answer to is: what is the appropriate amount of credit? You do not want to get in a situation such as we were in before the crisis where credit may have been too easy, which can lead to its own problems.

Q41 **Bill Esterson:** I would be very interested in the analysis you have on alternative forms of credit. If you could send that, it would be very helpful.

Coming back, Governor, you used the phrase "virtually firing on all cylinders" at the inflation report press conference. I have to say to you that I have many constituents who run very small businesses. They would not recognise that statement as their experience when it comes to borrowing money for what you might call day-to-day activities.

Chair: Just briefly, if you would.

Dr Carney: The first point is that I recognise that there are difficulties in access to credit as a small and medium-sized enterprise. There are structural issues in this country in terms of historical access and prospective access to credit for small and medium-sized enterprises that require determined, concerted policy action and will only have a return over time. That is not a monetary policy issue; those are structural issues. We have to deal with the system that we have in that regard.

In terms of the improvement in the financial system in this country, there has been a substantial, sustained improvement in both the availability and price of credit. We can send you a host of information around this. Some of it is contained in this report; much of it is contained in the financial stability report. That means that we have a system that is providing credit. That does not mean all businesses have access to credit and it does not mean the structural challenges in the financial system here have been rectified.

Chair: We are going to move on now.

Q42 **George Kerevan:** I want to test the groupthink. No one should take this personally. Mr McCafferty, what I have heard across the panel is: above-trend growth projected in the future; a tightening labour market; two years down the line, inflation will be above the 2% target; therefore, we should be taking action now on rates. I understand the scenario. When I look at the real economy, which no one has mentioned, over the summer, for the last few months, there has been marked deceleration: a significant fall in manufacturing orders—particular gloom there—and slowing growth rates. **The** Governor used a word he might live to regret. He talked about "wiggles". I do not call that a wiggle. There is something material happening. It could be short term, but, as the leading hawk here, I would like you to analyse for us exactly what has happened over the third quarter and how long that softening in the economy is going to continue.

Ian McCafferty: Let me start at a full-economy level. We should remember that manufacturing is only now 9% to 10% of GDP. It is now down to below 10%, to be frank, but let us say 10% for the sake of argument. Manufacturing in itself—as someone who used to run the manufacturing surveys available for this economy, I am very aware of the importance of manufacturing—is not necessarily a full guide to what is happening in the economy as a whole. It is true that the rate of growth in manufacturing output has slowed over the summer. There are a number of potential reasons for that. We have seen some slowdown in international growth and we have seen some appreciation in the rate of sterling, both of which will have an impact on export orders. Certainly, that is backed up by the surveys, which suggest that the rate of growth in export orders in manufacturing has slowed. However, total orders in the manufacturing sector, which includes the domestic side, have held up remarkably well.

As I say, manufacturing in itself is only—let us agree on 10% of the economy. Other parts of the economy demonstrate continued, robust growth. I would take strong issue with your idea that the entire economy is decelerating rapidly. We had relatively slow growth in the first quarter, but, as we know, first quarter growth in the UK economy is often revised up rather more than in other quarters. That proved to be relatively short-lived, in the sense that we had the bounce-back in GDP growth in the second quarter. We do not have an awful lot of evidence for the third quarter as yet, but on the basis of the evidence we do have, much of which is derived from surveys, we said in our August forecast that it looked as if third-quarter growth would hold up at 0.7% or so. If anything, in terms of the early levels of data, that is looking not unreasonable. From that point of view, I would not suggest—

Q43 **George Kerevan:** You disagree with the National Institute forecast, which thinks the third quarter will be well below 0.7%.

Ian McCafferty: I am not sure that I see that as yet from the data that we have and from the continued strength in all of the survey evidence that we see. We are now starting to see some pick-up in the housing market, both in terms of activity and in terms of prices relative to the first half of the year.

George Kerevan: Not in Scotland. It is the opposite.

Ian McCafferty: That I cannot comment on. For the UK as a whole, certainly all of the suggestion is that the housing market is strengthening after a weaker second quarter. As we now learn, again from today's data, real incomes are now growing at 3% as a result of the acceleration in nominal wages combined with zero current inflation, which bodes very well for strong consumer spending over the second half. I do not see an economy that is slowing dramatically over the course of the summer. I think it is still growing in line with or slightly faster than potential, and I think that will continue for the rest of the year.

Q44 **George Kerevan:** How long is the slowdown in the manufacturing sector—let us leave aside how important it is in terms of linkages and in terms of confidence—going to last?

Ian McCafferty: I do not have a * forecast on manufacturing specifically. We have lived with an economy in which manufacturing growth has underperformed that of GDP for many years and I suspect that will continue for a little time, given the conditions that we face. As I say, the fact that our main export markets are still growing relatively sluggishly, particularly in Europe, although they are improving, combined with a drag—although the drag is probably less than it would have been 25 years ago—from appreciating sterling in terms of the competitiveness of our exports suggests that that pattern is going to continue.

Q45 **George Kerevan:** I am testing, which is what we are here for. If we take your point about the relative unimportance of manufacturing, that leaves us with domestic consumption as the key driver. Let us move on to that. I share everyone else's fascination with Professor Forbes' report. As soon as I saw "Odysseus", I read the report. It was the first thing I read. From now on, whenever I write any economic piece I am going to put some nice classical allusion at the beginning. What you have said in the evidence is: "Consumption should continue to be supported by lower oil prices, strong real wage growth, and positive consumer confidence albeit hopefully less by reduced savings". Where do you think the level of consumer savings and consumer borrowing is going? It seemed to me the evidence was that our consumer debt had been increasing.

Professor Forbes: The evidence that I have seen suggests that consumer debt increased quite a bit before the crisis; it has come down since the crisis. I am not sure exactly where savings will end up or what the appropriate ending point is. It is a bit tricky too, as we have changed here how we account for savings, which makes it a bit more difficult to do historical comparisons. Savings have come down a bit recently, but what is going to be very important in consumption continuing to be strong is continued growth in wages. The wage data we saw today supports the idea that we are getting continuing support from wages, which should be able to continue to support consumption without drawing down savings to a point that it becomes a major concern.

Q46 **George Kerevan:** Perhaps you or Dr Weale could answer the following question, moving on from that, if that is the prognosis. The Chancellor is pursuing an economic policy where he wishes to run a permanent budget surplus, outside of erratic events. If we are running a permanent budget surplus, where in the national income accounts is the compensating permanent deficit?

Dr Weale: Going back to what the Governor said earlier, one of the consequences may well be that the balance of payments deficit is reduced. Nothing is certain—that may not happen—but there have been periods when there has been quite strong co-movement between Government borrowing and the external deficit, and there have been periods when it has been weaker. If private credit remains relatively stable, there would be room for an improvement there. I would also pick up on the point that Professor Forbes made that real incomes are growing fairly strongly at the moment, and that is likely to be the dominant force driving consumption and driving the economy.

Q47 **George Kerevan:** On the permanent budget surplus, you seem sanguine about the levels of consumer borrowing, so I still do not quite see where the permanent deficit comes from that compensates for the borrowing.

Dr Weale: The counterpart of the reduced level of Government borrowing is likely—

George Kerevan: We are talking about a surplus, not reducing borrowing.

Dr Weale: Remember that this will be a growing economy. You can have stable shares of borrowing, but I would expect a lot of the swing to be in the external deficit. We may settle down into a situation where the private sector is eventually saving more than it might have if there had been different Government policies, but over the horizon that we are looking at—remember we are looking, at most, at a two to three-year horizon—I expect a strong growth in income to be a driver of growth in consumption.

Q48 **George Kerevan:** I am accepting that, but, if the Government is running a surplus, the deficit on the trade and current account is being reduced and consumer incomes are going up so that your forecasts are not envisaging increased consumer borrowing, that does not compute. National income accounts have to sum to zero.

Ian McCafferty: You have to put the opposite sign to the current account, such that if we run a fiscal surplus we can run a current account surplus and the two cancel each other out.

Dr Carney: We are leaving out the corporate side. As you will have picked up, we have quite a strong investment profile for the corporate sector. The question, again—corporates have been saving, as you are well aware—is the extent to which corporate saving picks up.

George Kerevan: Corporate saving would worry me.

Dr Carney: It depends what the reason is. We have a productivity challenge in this country, as you know, and it is going to require greater corporate investment. We are seeing that on the ground. I will make two points, if I may.

Chair: Make them quickly.

Dr Carney: I will make them very quickly. First, I absolutely associate myself with Professor Forbes in terms of overall levels of household debt, which have been coming down. They have come down by more than 20 percentage points, relative to income. We are seeing, though, unsecured borrowing picking up relative to incomes, which we are watching. That is largely auto-related, which is consistent with consumer confidence being at a more-than-decade high, consistent with real income growth and consistent with some of the momentum.

I will make a point on the very short-term momentum and part of what I said, because you are striving to avoid groupthink. All things being equal, what we are seeing in terms of

SIPP surveys, some of the movements, the IoP and what happened to average hours in the labour force report, broadly, probably on the margin, to me suggest trend growth of 0.5% or 0.6% in this quarter, but I see the broad thrust of the forecast as being consistent.

Just as a point of information, as can appreciate, when we speak of the forecast, which is a best collective judgement, we have to describe a forecast that is the collective forecast and then we can provide our own shading to that. It is important that there is a consistent forecast that gives the central view, and then it is adjusted.

Q49 **Helen Goodman:** Professor Forbes, thank you very much for sending this report in. It was very useful. Towards the end, you say you think that labour market indicators suggest "that there is very little remaining slack […] in the economy". Reading the papers we had from the Bank, I can see that you are assessing the rate of unemployment using the claimant count and the ILO measure. Do you give those equal weight or different weights?

Professor Forbes: I wish I were that mechanical; that would make it much easier. I tend to look at a whole broad range of indicators when assessing slack in the labour market. I look at the unemployment rate and claimant counts. I also look quite closely at a number of measures of what we call "churn" in the labour market: vacancies, the vacancy-unemployment ratio, quits and how many people are moving jobs. It is that full picture—

Q50 **Helen Goodman:** It is very interesting that you say that, because the Government has stopped publishing some of those ratios. If you have access to those statistics, which we no longer get, we would be very glad to see them. I do not know whether you are aware of this, but there have been some changes to the way benefits are administered at the moment. If you knew that claimant count was 2.8%, not 2.3%, would that change your assessment of the labour market?

Professor Forbes: Any one data point that moves around generally does not change my assessment of the labour market. There is so much volatility in the data that one thing I have learned is never to change my view dramatically based on one change in a data point. I really look for trends over time and movements. That is confirmed by some of the most recent data we have seen in the labour market. We have seen quite a bit of volatility month to month, and that is why it is important to look through that.

Q51 **Helen Goodman:** Trends are important, but levels are important as well, are they not?

Professor Forbes: Yes, but in terms of assessing the overall slack in the labour market and tightness in the labour market, it is very difficult now to know exactly what an appropriate level is to assess the amount of slack in the labour market. There has been such structural change in the economy, first from the crisis and then from other changes in policy and the environment, that it is very hard to put a number on exactly what the appropriate level or the equilibrium level for any of these measures is. Again, I go back to the fact that I tend to look at a whole dashboard of indicators and I tend to look at trends and movement rather than putting weight on any specific indicator or number at any time.

Q52 **Helen Goodman:** Are you aware of the work done by Glasgow University on the claimant count, suggesting that it is maybe underestimating by about a quarter because of the change in the conditionality rules?

Professor Forbes: I have seen it; I am not an expert on it.

Q53 **Helen Goodman:** Can I move on to ask you about how you make assessments of underemployment? Traditionally, this was something that we thought was a big problem in the Southern European countries, where people were still working half their time on a farm and half their time maybe waitressing or something. Could you tell me how you assess underemployment in the British economy?

Professor Forbes: Again, there are a lot of indicators. One indicator that I have followed closely is the percentage of the workforce in self-employment. After the crisis, there was a big surge in the jobs being created being in self-employment. I had big questions about how much of that was by choice. You could come up with a number of reasons why people like to be self-employed—maybe not working five days a week, or 40 hours a week or more—and choose to have more flexibility and choose to be self-employed, but it also was not clear whether some people were being forced to be self-employed because they could not find more traditional, full-time, more secure jobs. That was one measure I was watching closely as a potential indicator of underemployment or excess slack. It is interesting; as the labour market has tightened over the last year, we have seen a remarkable move of people out of self-employment into full-time employment and full-time jobs. For me, that has been a strong indication that some of what was underemployment has been diminishing.

Q54 **Helen Goodman:** I want to ask you about the impact on the numbers of people who have contracts that are less than full-time contracts. I went to the local work and pensions office in my constituency and they told me that the supermarkets have changed their policies on employment and they are now offering people only eight-hour contracts. Britain is a nation of shopkeepers: nearly 2 million people are employed by these supermarkets. If this is a common pattern, this is very significant. In the first part of your report, you are saying you are not clear how many people there are who are willing to work more hours. I am wondering whether you are looking at these changes in people's employment terms and conditions and at these shorter-hours contracts and what impact that might be having.

Professor Forbes: I will give you an answer. I would like to highlight that Martin Weale is an expert on his and has worked on some of these data sets, so I am sure he can also chime in. At the Bank, we do track some indicators based on surveys of how many people would like to work more hours and how many would like to work fewer hours. There has been a fairly large number of people who would like to work more hours, and that has been a factor in our forecasts of slack in the labour market. According to work that Martin has done—again, I hope he will chime in in a minute—some of the people who say they would like to work more hours, when push comes to shove and they are offered those hours, do not take it up, but some of them do. We do take into consideration how many people are saying they would like to work more hours and that does go into our measure of slack in the labour market.

Dr Weale: Could I add to that that the study I did looked at people who said they would like to work more hours and then looked at the same people a year later and how much they were actually working and whether they were still saying they would like to work more hours. While I am afraid I do not remember the precise numbers, it was very clear that—this is an illustration—people said perhaps they would like to work 12 hours a week extra and it was particularly young people who said they would like to work longer hours. Older people tended to say they would like to work shorter hours. For the young people who said they would like to work, say, in the order of 12 hours longer, a year later, if they were working, say, six hours more, they had stopped saying that they would like to work longer hours.

Q55 **Helen Goodman:** I get the idea. What were the two dates when you did this?

Dr Weale: I did some averaging. I used the Labour Force Survey. That is a survey that goes to the same people for five successive quarters. If you just look at one round of the Labour Force Survey, you do not have very many people in the sample, so what I did was averaging. This was work that I presented last year, I think, and so things may have changed. We have to keep an eye on that, but we always have to remember that what people say they would like is not, as things turn out, what they were actually like.

Q56 **Helen Goodman:** For sure. There is an issue about revealed preference; I understand that. When you were asking people this question, were people responding differently depending on whether they were on, for example, a zero-hours contract or an eight-hour contract, or if they were on a 35-hour contract? Did you go into the data at that level?

Dr Weale: Typically, it is the people who are working relatively short hours who say they want to work longer. There are not many people who are working 35 or 40 hours a week who say they would rather be working 50 or 60 hours a week. As far as I understand it, the Labour Force Survey—and it is a Government survey; it is not a survey that the Bank did or that I did—does ask people about their usual working hours as well as their actual working hours, but it does not ask for precise details of their contracts.

Q57 **Helen Goodman:** I am being hurried up, so I want to address a question about wage changes to Mr McCafferty. Again, I want to ask you to reflect on the distinction between increases in wages—wage growth—at a time when wages are not very high and increases at a time when they are at a historically high level. I am sure you are aware of the statistics that were published over the weekend by the Resolution Foundation, which found that average wages are not going to reach their pre-crisis level for another two years. One of the reasons for this—they did quite an interesting paper and they identified four different factors—is what they call the "wage distribution effect". Do you take a different view of wage growth at a time when wages have been depressed from one when they have been very strong?

Ian McCafferty: We certainly look at wage distribution effects. We have covered this in some detail in recent editions of the inflation report, where we have suggested that some of the reason for very low wages over the course of the last year and a half to two years or so has been a change in the composition of the workforce. We have seen faster than normal growth in younger, less skilled workers, many of whom are now being re-employed having been let go during the depths of the recession, which has had a depressive effect on average weekly earnings.

Our mandate is for inflation, and it is the rate of growth in wages—or, I should say, in unit-labour costs, once we allow for productivity growth—that is important for inflation, rather than the absolute level. While I clearly have some sympathy with those who have, as it were, lost out as a result of the economic crisis and the ensuring recession, we have to look at wage growth in terms of how we achieve our mandate.

Q58 **Helen Goodman:** Can I ask a question on QE of the Governor?

Chair: Just one last very quick question. Governor, you will promise to be brief in your reply, whatever may come.

Helen Goodman: At one point, QE consisted of some purchases of corporate assets. My understanding is that now, as you are maintaining the stock—not changing the stock, but maintaining the stock—you are purchasing only gilts and it is a completely gilt QE. Could I ask you why that is and who makes that decision?

Dr Carney: The purchases of corporate assets were made at the time of intense dysfunction in the corporate bond market. It was the Bank acting as, in effect, a market maker of the last resort. We ran auction mechanisms. This was at the height of the crisis and it was, in effect, to try to re-start the corporate bond market, to provide some liquidity in the corporate bond market, which in and of itself is an important financing channel.

The judgment of the Monetary Policy Committee for subsequent asset purchases to provide stimulus was fixing a bit of the transmission mechanism. The asset purchases that were pursued through the APF were to provide stimulus to the economy in order to achieve the inflation target. The judgement of the MPC, before I arrived, was that the most effective way to provide that stimulus was through the purchase of gilts. It is a distinction between market functioning and pure monetary stimulus.

Q59 **Mr Steve Baker:** Good afternoon. Just to rewind a bit, is there any time when you can put a precise estimate on the output gap, Professor Forbes? Bearing in mind what you have said—that, given structural changes in the economy, it is impossible to put any precise estimate on the output gap today—is it ever possible to put a precise estimate on it?

Professor Forbes: When you are far away from equilibrium, you can put a rough estimate on where it is; when you are very close to reaching equilibrium and closing that output gap, it is very hard. That is during the best of times—during normal times—with timely data. Right now, the economy has undergone such structural changes that it is incredibly difficult to put any precise number on it.

Q60 **Mr Steve Baker:** You are saying it is more difficult to discover the number if it is smaller.

Professor Forbes: Because then little errors will make a big difference.

Q61 **Mr Steve Baker:** We have had some fascinating exchanges with the OBR about the importance of the output gap, but, Governor, you said at some stage that there was a wide range of views on the Committee about exactly where it was. You said it was "an inexact science, to be polite". I am really delighted to find we agree that the output gap is susceptible to impolite adjectives. I agree with you. Does it concern you that so flawed a concept is so important to all our forecasts?

Dr Carney: It depends on how one uses that estimate and how one incorporates that estimate not just in forecasting but in the development of policy. We do not have a mechanistic rule, using some estimate of an output gap, precise or imprecise, and then mapping that into the stance of monetary policy. Absolutely not. So, no, it does not concern. We, as individuals and collectively, are thoughtful about the degree of slack in the economy, the lags between that slack and inflationary pressures, the lags in monetary policy and the appropriate stance of monetary policy in order to achieve our inflation target.

Q62 **Mr Steve Baker:** We are short of time, as ever. Do you ever discuss this concept with the OBR, who seem to find it perhaps more intrinsic to what they do than you do?

Dr Carney: I personally do not.

Q63 **Mr Steve Baker:** Do you think it might be a good idea for the Bank to have a—

Dr Carney: I would add, if I may, Mr Baker, the OBR does attend our pre-MPC meetings. It is kept in the loop, so to speak, with our staff's current thinking in terms of the amount of slack in the economy and, implicitly, where the output gap may be.

Q64 **Mr Steve Baker:** If I were to summarise my understanding of the range of conversation we have had, in previous sessions I was allowed to get away with characterising the output gap a critically important nonsense that is difficult to discover, and I do not think I have changed my view since you said what you have.

Dr Carney: I would disagree in terms of your criticality. I would reinforce, or re-emphasise, that there is not a mechanistic mapping from the estimates, as individuals or as a group, that we make to monetary policy. It is a useful organising principle. It can be a useful communication principle in polite company.

Q65 **Mr Steve Baker:** I will perhaps ask the staff to tie that up with what the OBR said and see how the two come together. On the national living wage, I am sure everybody here wants to drive up real wages. Does the national living wage represent any risks to the macro economy?

Dr Weale: On its own, the effects of the national living wage on average wages are likely to be fairly small. That is the key assumption that is built into our August forecast, and that is based on an analysis of the numbers of people likely to be affected and what that means averaged out across wage costs in the whole economy. What remains to be seen is whether the compression of differentials that could result from that is offset by substantially higher pay increases for those earning a bit more than the national living wage. When the minimum wage was introduced, I think it is fair to say that the effects of that type were generally weaker than had been expected. The national living wage is something different and we do not know what the outcome will be, but I suspect that different members of the committee may have different views about the outlook for wages, partly because of different judgements about that.

Q66 **Mr Steve Baker:** I need to make progress, Governor, so I will bring you in on this next part, if I may. In the Budget, the Chancellor, if I recall, said that he expected the national living wage to cost about 60,000 jobs but that that was offset by the million or so jobs the Government expected to create over the course of the Parliament. Do you think there is a level at which the national living wage would be really significant in that calculation between the cost of jobs, the effect on the overall economy and our ability to create new jobs in order to employ people?

Dr Carney: Two points, quickly. In terms of our forecast, which incorporates the national living wage, I associate myself with Dr Weale. Beyond the forecast rise, in four or five years, we are thinking about 0.1% or so on CPI. That is on the level of CPI. That is set against the 35%-plus wage. That estimate includes an increase in those adjacent to those who would be paid the national living wage. That is the first point.

One of the things from the experience of minimum wages internationally has been that if you get notably above 60% of median wage, a nonlinear effect on employment has been observed. Again, it is not perfect, but those types of trade-offs would become more acute.

Q67 **Mr Steve Baker:** At least some of you were in Jackson Hole for the conference this summer. While you were there, I was at a parallel conference, which was discussing whether central banks were the problem or the solution. I think you know where I stand. You should find on your desk this chart, which I put there earlier. What it shows is the income growth of the top 10% versus the bottom 90% from 1948 to 2012. Prior to the 1971 end of Bretton Woods, you can see that the income of the 90% grew at a rate that led the 10%. A few years after the end of Bretton Woods, we find that the income growth for the bottom 90% stagnates while the income of the top 10% accelerates away. I can think of reasons for that. Is this an analysis that you have considered doing at the Bank of England? If not, would you do this analysis to try to indicate how the income growth of the top 10% and the bottom 90% has changed as the monetary system changed and became chronically inflationary after 1971?

Dr Carney: A couple of things. First, outside of the monetary policy remit of the Bank, we have been looking at issues of inequality and their impact on growth, financial stability, etc. So, yes, we have, and we can replicate this, if it is of interest, for the United Kingdom.

Mr Steve Baker: It certainly is, yes**.**

Dr Carney: The second point I would make is the system became chronically inflationary for a period after the fall of Bretton Woods, but not subsequent to the adoption of inflation targeting and independent central banks. That has been a difference.

The third point, most importantly, is what else has happened over this period that has helped to drive these very marked increases in inequality. It is not just the breakdown of Bretton Woods. That is not the key driver. The key drivers are globalisation and technology. That is amplifying the returns to those in the top income group—corresponding with changes to the tax code, particularly for the US, which, appropriately, you have listed here. You have taken out carried interest, I note; you might have added that as well.

Mr Steve Baker: There is another slide with further—

Dr Carney: Those factors amplify returns to the famous, the fortunate and the skilled, and suppress returns—through factor-price equalisation, through tradable services, through outsourcing and other factors—for those in the bottom income quartile. So, there are big factors away from monetary policy. The one thing monetary policy was doing, once it got its act together in the United States, was to ensure price stability so that the actual wage growth that did occur for those individuals gave some prospect of real income growth.

Q68 **Mr Steve Baker:** I want to draw your attention to a paper from the House of Commons Library and the ONS, which shows inflation from 1750 to 2003. It is only 2003, but the charts look like that on a linear and a log scale. It depends how you measure inflation, but, according to this data, the system has been, simply, chronically inflationary since the end of Bretton Woods.

Dr Carney: Since the adoption of inflation targeting, inflation in the United Kingdom has been 2%—that includes the crisis period—and the volatility of inflation is one-fifth of what it was prior to the adoption of inflation targeting. Over the relevant period—the period over which we have a clear mandate and accountability, and a framework such as we are experiencing today—monetary policy has delivered low, stable and predictable inflation.

Q69 **Mr Steve Baker:** If we were to look, say, at asset prices, UKFI came before the Committee last week and I had to get the thumbscrews out but, in the end, we agreed that their policy and the way they were operating—they are not there to challenge monetary policy—relies upon a height of prices of bank shares that is there substantially because of QE. We did extract that from UKFI last week. It took some effort. My concern is that we are looking in the wrong place. Consensus seemed briefly to emerge around the time of the crisis that central banks had not been looking at the right measure of inflation. It seems to me now that, when you look at wealth inequality, it might well be that central banks, in looking at the measures of inflation that you do, have missed out on the redistribution effects of prices being pumped up by easy money, which is what, effectively, UKFI told us in their evidence. What we are finding is that this system of money is widening wealth inequality and, ultimately, leading to political radicalism and, if I may say so, Jeremy Corbyn and "QE for the people". What is going on that has led to "QE for the people" being a credible strategy for a Shadow Chancellor who has put on the record that he is a Marxist?

Chair: We have Steve Baker's view of it, but today we are also interested in the Governor's.

Dr Carney: In my personal view, the issues around inequality in advanced economies—I will speak of them as a whole—have some fundamental structural drivers and require a concerted suite of policy actions. Monetary policy is not part of that response. Monetary policy's contribution is to keep prices low, stable and predictable. In relation to redistribution of income beyond that, reinvestment in talent or changes in the structure of the economy, there are a host of other Government agencies required. To make a very precise point on valuation and banking, though, if I may, whereas prior to the crisis banks traded at two to two and a half times book value, currently they trade around book value. Valuations relative to the underlying asset base of the banks—those valuation metrics have come down quite considerably.

Mr Steve Baker: We may have to go back to UKFI and challenge their statement that bank shares were in an exceptional position because of QE. I am being encouraged to leave it there.

Chair: For the time being, but I am sure we will be back before long.

Q70 **John Mann:** Mr Baker is getting some interesting new converts to his views on central banking in the House. Mr McCafferty, rollover is coming again with QE. Who is losing out?

Ian McCafferty: I am sorry; I do not understand. "Rollover" is not a term I—

Q71 **John Mann:** You are maintaining the levels of QE, so who is losing out from QE?

Ian McCafferty: I see what you mean. There are clearly those who would benefit from higher interest rates. To the extent that we are maintaining monetary policy, whether through reinvestment of the QE assets or pausing before we move to any lift-off on interest rates, there are those elements of society who would benefit from higher interest rates. However, I would say that, while those could be argued at face value to be losing out from loose monetary policy, they have all benefited from the fact that the economy has stabilised and that we have seen very solid growth over the course of the last two years as a result of the monetary policy easing that my colleagues, certainly prior to my arrival on the committee, undertook.

Q72 **John Mann:** Are pension funds losing out?

Ian McCafferty: It depends on what you mean by "losing out". Clearly, some yields will be lower in terms of their income, but the underlying value of the assets will have benefited from the strengthening of the economy.

Q73 **John Mann:** Why keep it at the same level? Why not do less, or why not do more, Mr McCafferty?

Ian McCafferty: Are we talking about QE specifically here?

John Mann: Yes, QE specifically.

Ian McCafferty: The view of the committee—and I share this view—has been that we wish to move to a position in which the interest rate tool, for which we understand a great deal more about its impact on the real economy and on inflation, regains its role as our marginal instrument. In the early stages of a tightening cycle, that means we should be moving interest rates before we consider changing the level of purchased assets that we have in the economy. As a result, we should therefore be holding the level of assets constant through reinvestment to allow us to re-establish that role for the Bank rate.

Q74 **John Mann:** Dr Weale, should anyone have any concerns? This has been going on for some time; it could be going on for a long time further. Should anyone be the slightest bit bothered about QE and about reversing it at some stage in the future?

Dr Weale: Work I have done on QE suggests—this was something of a surprise to me—that it has been quite an effective monetary policy tool and, secondly, that it was effective even at times when there were not very acute stresses in financial markets. From my perspective, I see it as a monetary policy tool. One would not want to maintain the stock as it is indefinitely. At some point, when the Bank rate has returned to much more normal levels—I do not expect still to be on the committee then—and particularly a point from which it is possible to reduce it substantially, my successors may well think that a gradual run-down in our stock of assets would be a sensible thing to do in the background. Different people have different numbers in mind, but had this all been happening sooner, I could have seen myself thinking of, maybe, the committee deciding to sell off something like £50 billion over a period of one year and setting monetary policy with that going on in the background.

An additional point that David Miles, my former colleague, made is that it is perfectly possible that banks will want to have greater liquidity than they used to have before the crisis. If that materialises as wanting higher deposits with the Bank of England, then we need something as security for that. You might well ask what the point is of the Government issuing long-dated debt for us to transform it into short-dated debt, which is essentially what I see QE as doing. There were good reasons for doing that during the crisis, but would you want that as a permanent state of affairs? My sense would be that, to the extent that banks do want to hold appreciably larger deposits than they used to, there would be a case for saying that the Government should convert that residual component of QE into something like Treasury bills with a much shorter security. The maturity would then more or less match the deposits that the banks have with the Bank of England and, in those circumstances, you will not get the sorts of questions that arise about capital gains and losses and whether those are real capital gains. It will all be much more transparent.

Q75 **John Mann:** That is a very interesting concept and argument. Rather than explore that further, Governor, you have the opportunity to buy other assets—what some people are describing as "stuff". Why do you not buy stuff now, seeing as everyone is very comfortable with the way QE is going and the downsides? Why not invest in the real economy and do so next week?

Dr Carney: Thank you for the question, Mr Mann. The first reason not to buy gilts or stuff or anything else is that my personal orientation—and, I would say, the orientation of the committee—is that the next move for monetary policy is likely a tightening. In other words, the next move in interest rates is likely to be up. If we were to do anything, it would be to reduce monetary stimulus, as opposed to provide additional monetary stimulus. That is the first reason.

John Mann: For inflationary fears.

Dr Carney: In order to bring inflation back up, and not to go through the inflation target but stay there. That is the first reason.

If we abstract from where we are in the economic cycle and we were in a position where we wanted to provide monetary stimulus and we were in a position where the interest rates were as low as they could go and we wanted to provide additional stimulus and the question became what to buy, which I guess is the essence of your question, the MPC would take a judgement based on what the most effective asset to buy is. We can buy more than just gilts. What is the most effective asset to provide in providing stimulus to the economy? We would also be conscious of avoiding making political decisions—allocative decisions—in our purchases. For example, even in the case that Ms Goodman raised with corporate bonds, there was an algorithm created in order to ensure that we were not picking certain bonds and therefore favouring certain companies as opposed to the market as a whole. When one moves into the world of other assets, whether they are corporate bonds or bank loans or equities, we would have to be very careful—this is an extreme hypothetical, because it is not the orientation of the committee at all—to ensure that there was not an allocative decision being made, which is effectively a political one.

Chair: It is the same answer your predecessor gave.

Dr Carney: I am sure he said it better.

Q76 **John Mann:** Who would be the losers if you did that?

Dr Carney: If we began to undertake a "stuff" purchase programme, for example?

John Mann: Yes.

Dr Carney: In all of our monetary operations, whether it is interest rates or quantitative easing or any asset purchases, the motivation, under statute—under the Bank of England Act—has to be to meet price stability objective, which is defined by Parliament. Parliament has given that; that is our primary objective. The Chancellor defines, on an annual basis, exactly where they see the definition of price stability. We, as technocrats, have an obligation to follow the statute.

Q77 **John Mann:** I understand that, but, with freedom to operate, who would be the losers?

Dr Carney: The issue would be imperilling, potentially, the achievement of price stability. The consequence of that would be inflationary. The people who tend to get hurt the most by inflation are the poor and the elderly—those who cannot hedge themselves. That has been the experience throughout history and I am sure that would be the experience in the future if the Bank of England were not to conduct its policy in a way that was consistent with achieving its mandate from Parliament.

Q78 **John Mann:** One final question. Would the position of the Governor, as you understand the position—the excitement of the job that you were enticed to take on—be tenable if a Chancellor of the Exchequer started instructing you in that way and intervening in the decision making?

Dr Carney: Again, we are technocrats; we are governed by the Act. Under the Act, the Chancellor cannot instruct the Governor.

John Mann: No, but if that Act was removed by Government.

Dr Carney: If the will of Parliament were to remove or amend or change the Act. Under the current Act, any instruction or guidance is for extreme economic circumstances, and I would note that even in the crisis it was not judged to be "extreme economic circumstances". Of course, if it is the will of Parliament and the will of Parliament is to adjust, then—

Q79 **John Mann:** That was not really my question. My question was whether you would find the job as attractive if you had a situation where that Act was not there and the Chancellor of the Exchequer was instructing what to do and what decisions to make.

Dr Carney: The construct here, with a central bank that has operational independence to achieve a mandate that is defined by the people through Parliament, is the right model, and it is a model under which I, as Governor, and my fellow colleagues on the MPC are fully accountable for our performance against a clear objective. Our responsibility is to keep our eye on that ball and achieve it, and that is what we will continue to do.

Q80 **Chair:** I would like to ask a question about the publication of transcripts in arrears, which has recently been put into place, if I get time. The wind-ups have started and we will close the hearing if a Division is called.

As you know, some time ago this Committee discovered that recordings were no longer made or retained of MPC work. We asked for recordings to be made, we asked for transcripts of them to be made and retained, and we asked for those to be published after an interval. It was extraordinary that none of this had been happening under you predecessor. You instigated a review under Kevin Warsh. He came forward and you supported his view, which was very welcome, that there should be publication with a lag of eight years. This is a great step forward for transparency. Mr McCafferty, have you found that the fact that, in eight years' time, what you have been saying will verbatim be published has had any effect on the way you conduct your business?

Ian McCafferty: Very little is the answer. It makes me think twice about the precise adjectives I use when making my presentation to the rest of the committee as to exactly the arguments behind my views, because I know that I will be held even more accountable for them than I am now. Beyond that, in terms of the ability to discuss and the ability to come to an independent decision, it has made no difference at all.

Q81 **Chair:** It has made no difference. What about you, Professor Forbes?

Professor Forbes: The structure, the way it has been adopted, has not fundamentally changed how we discuss the policy decision—the final sections of our meeting.

Chair: What we are talking about here is the Monday meeting, in the way that it is set up, prior to the Wednesday decision. Have you changed the way you behave in that meeting?

Professor Forbes: I am more careful to write down in advance exactly what will be said than I was previously.

Q82 **Chair:** So, you have changed. Do you think the hearings are the poorer for something that you would have said had you not scribbled it down, or the richer, because you spend more time thinking about what to say?

Professor Forbes: It depends on the day. You do think much more carefully about the adjectives, as Ian said, when you are writing them down, but it does mean there is less debate and less discussion than there previously was, because we are so careful to write things down in advance. It does take away some of the responses—

Q83 **Chair:** You are very careful about what might be thought about you in eight years' time, then, is what you are telling us.

Professor Forbes: No, it is just that the whole proceeding becomes more formal and there is less give and take.

Q84 **Chair:** We are having a relaxed conversation in the privacy of this room, are we not, and you do not seem to be particularly nervous about expressing your view?

Professor Forbes: No, but—

Chair: We are on the record in real time.

Professor Forbes: The first day of our meeting is an amazingly free-form discussion with a lot of back and forth and criticising ideas. We do not have those types of discussions on the day that is transcribed, and we do not have them here either.

Q85 **Chair:** Dr Weale, you have expressed considerable concern about that. Why are you so disconcerted by this eight-years-in-arrears burst of sunlight? You have effectively said this will make your contributions “more stilted”.

Dr Weale: In some sense, that is perhaps for the other members of the committee to judge rather than for me to judge. I thought, looking at the transition, that my contributions had perhaps become a bit more stilted. I share Professor Forbes’ view. I find myself reluctant to adjust what I say in the light of what colleagues have said previously at that meeting. I tend to stick more closely to my text than I would have in the past.

Q86 **Chair:** Do you agree with Professor Forbes’ judgement that there are pluses and minuses? She is saying, “It might make me more careful and more thoughtful about what I am going to say. On the other hand, maybe there is some interchange that is lost.” In other words, there is some benefit and some loss to this. Or do you go with Mr McCafferty’s view that, overall, the effect is probably going to be negligible once it wears in?

Dr Weale: I should also say that I am speaking only for myself. As I have got more used to it, perhaps the text I am writing is more like what I would have taken to the meetings in advance of the transcript, so perhaps there is an element of adjustment. The issue of transparency is important. For me, the main plus is that people will now be able to see exactly what we are saying at that meeting, whereas until the transcripts were introduced they had to rely on what we said in speeches, interviews, newspaper articles and so on.

Q87 **Chair:** We will give the last word to the Governor. You have brought this system in. We are grateful, as Parliament, to you for bringing this sunlight to bear in the long term of the process that is being conducted. Has your chairmanship of this meeting been affected? Will people in future years say, “Here is the way Governors used to behave and now here is the way they behave under publication conditions”?

Dr Carney: It has been welcome. It has performed better than I would have expected. One of the advantages has been—at least in my short time with the previous system and now this system—that for all of us, myself included, there is a more coherent, whole rationale for the position people are taking. As an aside, if I may, one of the challenges of having a meeting every month is that it is almost a running conversation and so the actual decision can sometimes become a bit partial. Having this discipline brings some discipline to restating a stance and what has changed.

Q88 **Chair:** You see that as a plus.

Dr Carney: I see that as a plus. I also agree with my colleagues that for those who want to go through the experience and study how central banks make decisions and why we made the decisions we are making in real time, it will be incredibly valuable.

Q89 **Chair:** That is why we proposed it. Have you changed your behaviour, Governor, in any way?

Dr Carney: What I have changed is that I do have a more scripted part of my view. The only thing I do not change is that I speak last so I try to pick up—

Q90 **Chair:** Do you let the others in a bit more, perhaps? I am teasing you a bit, but you are very conscious of the importance of making sure everybody gets their turn, perhaps.

Dr Carney: I am very conscious to make sure everyone gets their turn in the discussion meeting, which is the free-form, robust, evidence-based discussion Professor Forbes described before, which is the opportunity to refine views, to challenge, to take new information and to have some follow-up. The fact is the decision meeting is a meeting for a decision. You show up with your view. It is an imperfect analogy, but it is as if you show up for a vote in the House. Your mind is pretty much made up, and we go through in random order, with the sole exception that the Governor speaks last, by convention established, appropriately, by Mervyn King.

Chair: I think it was important that we gave an airing to the concern that was expressed by Dr Weale about the new system, and the wider public can judge what they have heard today from the three externals as well as the Governor. All four of you, thank you very much for coming to give evidence today. It has been extremely interesting, as usual, and I hope you have an easier journey back to the Bank than you did getting here.