HOUSE OF COMMONS

Treasury Committee

Oral evidence: Bank of England Monetary Policy Reports, HC 143

Wednesday 16 November 2022

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Watch the meeting

Members present: Harriet Baldwin (Chair); Rushanara Ali; Anthony Browne; Emma Hardy; Siobhain McDonagh; Alison Thewliss.

Questions 604 - 725

Witnesses

I: Andrew Bailey, Governor, Bank of England; Dr Ben Broadbent, Deputy Governor, Monetary Policy, Bank of England; Dr Swati Dhingra, External Member, Monetary Policy Committee, Bank of England; and Dr Catherine Mann, External Member, Monetary Policy Committee, Bank of England.

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Examination of witnesses

Witnesses: Andrew Bailey, Dr Ben Broadbent, Dr Swati Dhingra, and Dr Catherine Mann.

Q604 **Chair:** Welcome to this session of the Treasury Committee to cover evidence on the Bank of England's Monetary Policy Report. I do appreciate how unusual it is for you to be coming in and giving evidence on the eve of a major fiscal event, so I am happy to put on record that nothing you say today should be interpreted as any kind of direct signal about the contents of tomorrow's Autumn Statement.

I also put on the record that my cousin is still a senior adviser at the PRA and I feel I need to note that for the record.

Andrew Bailey: A very longstanding colleague.

Chair: Can the witnesses introduce themselves, starting with you, Governor?

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

Dr Mann: Catherine Mann, External Member of the Monetary Policy Committee.

Dr Broadbent: Ben Broadbent, Deputy Governor for Monetary Policy.

Dr Dhingra: Swati Dhingra, External Member, Monetary Policy Committee.

Q605 **Chair:** Welcome. I think this is your first session, Swati, isn't it? It is very good to see you.

Governor, 11.1% inflation and you will be aware that, long before Russia invaded Ukraine, members of this Committee have been flagging that there were potential inflationary upside risks in the economy. Your goal is 2%. What has gone wrong with your forecast modelling?

Andrew Bailey: If you do not mind, let's go back to Covid for a moment and work forward. Two and a half years ago now, the economy was hit by a huge shock in terms of the pandemic and it was obviously necessary and appropriate that monetary policy responded.

Since then, we have had a series of supply shocks in the UK economy that—particularly when you look at the labour force—have reduced the supply capacity of the UK economy relative to demand. To put those shocks in chronological order, there was what we tend to call a supply chain shock in the recovery from Covid. That was a global shock because it reflected goods and services demand and stretched supply chains, particularly involving China, and I would add that it is useful to say that I think we are now seeing the evidence of that shock coming off.

The next shock I would highlight is in many ways the big one, which as you said is Russia-Ukraine. It has had a very big impact in two areas, energy and food.

A third shock is a domestic shock, which is the tightness of the UK labour market and the fact that the UK labour force has reduced in size relative to the pre-Covid number. I think I am right in saying our colleague Jonathan Haskel made a speech last week in which he covered this and included a rather interesting chart that shows that the UK is the only OECD country showing this pattern of labour force shock.

To come back to your question of what we look back on, I would ask the question: if we go back a year now, how easy would it have been to forecast that pattern of UK labour supply? With Russia-Ukraine, if you do not mind my saying so, it was very hard even a year ago to forecast what was going to happen there. A year ago there was a question over the supply chain shock. Was it going to be transient or not? I would say that, taken on its own, the evidence is that it is now wearing off. The problem is that we have this sequence of shocks.

If I can go back to the labour force shock for a moment, I think it was very hard a year ago. It dominated our thinking a year ago. A million jobs were furloughed right to the end of the scheme. It was round about this time last year when we were beginning to get the evidence as to what was going to happen in the labour market as the furlough scheme ended. There was uncertainty and you can see this not just in our forecast but in all the outside forecasts as well. Was it going to lead to an upturn in unemployment, which nearly every forecast said it would and we were at the low end of that distribution? Of course, it did not and one of the reasons for that was because of the shrinkage of the labour force.

I am sure a lot of people will spend a lot of time trying to work out what we could have foreseen about that at this time last year, but I think it was a very difficult call to make then.

Q606 **Chair:** Therefore there was nothing wrong with your models?

Andrew Bailey: No. With the benefit of hindsight, obviously there were things that would have been different. The question I ask myself—and I have said this in speeches—is about the labour force. I do not think we could have foreseen that Russia was going to invade Ukraine.

Q607 **Chair:** I agree that we should put that to one side. We need to focus on the supply chain and domestic factors. You are now acknowledging, Governor, that you did miscalculate the potential risks when furlough came to an end. That is what I am hearing you say.

Andrew Bailey: It is perfectly reasonable to take both of those things, and, by the way, I think one of the challenges here is the view that, if you take an individual single supply shock, it works its way through and you do not necessarily respond to the first effect; it is what might happen thereafter.

If we had had only one supply shock—and in the initial period of recovery from Covid, I think that was a reasonable assumption as it took effect—the response would be very different from the situation now, where we have had a sequence of supply shocks with no breaks in between. This is one of the challenges that central banks around the world are facing. We

have had a sequence of supply shocks, a sequence that I do not think you could have predicted at the time.

Take the two shocks you mention. The supply chain shock—

Q608 **Chair:** Governor, do you not acknowledge that having a very loose monetary and fiscal policy at the time, and a situation where you had your foot on the floor with the quantitative easing programme, the risks in that scenario were for inflation to take hold and for it to become the kind of wage-price spiral that we are currently seeing our constituents suffer from?

Andrew Bailey: I totally understand that, but can I respond by saying that that would have required us to tighten monetary policy at the height of the pandemic because of the transmission mechanism. Put like that, I am afraid I do not think that is a very plausible thing.

Q609 **Chair:** But 0.1%?

Andrew Bailey: We were in the middle of a pandemic when it was having the economic effects that it was having. I really do not think that is a reasonable thing to have done based on what we knew at the time.

Q610 **Chair:** I will turn to Catherine Mann now because, Catherine, you have been very much at the hawkish end of the spectrum on the Monetary Policy Committee. I know you have been calling for a higher bank rate increase than your colleagues, I think it is four times now. How do you respond to this criticism? Are you happy with what the Governor is saying—that there was absolutely no way this terrible wage-price spiral we are now experiencing in the UK could have been forecast?

Andrew Bailey: I did not say that. I am happy to come back later but I did not get to the end of my point on the labour market. Let's come back to that. I don't want to interrupt.

Chair: We will come back to the labour market.

Dr Mann: First, I am very delighted to be here with you in person. That is good.

You have noted that my votes have tended to be more forceful than that reached by the committee. The foundation of that is twofold. One reason is that I have been particularly attuned to data on price expectations of firms, households and in financial markets, so I put a very high weight on price expectations. That is one way of trying to gauge prospects.

I also put a very high weight on research that has tended to find that under conditions of inflation uncertainties—in other words, you do not exactly know how it is going to proceed—that frontloaded policy tightening is more likely to achieve an outcome that is better controlling of inflation.

With all that said, however, the shocks that are external to the UK economy—specifically the energy shock and the global goods shock—continue to dominate the numbers, but what we care about is the extent to which they become embedded. Looking at where we are now, over our

last few meetings we have taken a much more aggressive approach as this embeddedness has become more apparent.

Q611 **Chair:** Catherine, thank you for that. Are you saying that, if the whole committee had agreed with you and that you had moved earlier and faster, the overall picture on inflation would be better now and we would not be suffering from 11.1% inflation today?

Dr Mann: I think we have to go back to the magnitude of the energy shock and the way in which it has been calculated.

Q612 **Chair:** The Governor said that 80% of inflation was coming from the invasion shock and the remaining 20%, you felt, was more widespread. Does that continue to be your assessment, Catherine?

Dr Mann: I think the general view is that more of these shocks have become embedded into the actual price and wage setting in the economy and continue to support higher wage and price expectations. In that regard, taking more forceful action earlier on—as I say, the research identifies a frontloaded policy strategy as potentially having a superior outcome with regard to inflation.[1]

Q613 **Chair:** That is very interesting. We would be interested to see that research because that is different from what has actually happened.

To go back to the Governor on the quantitative easing point, last week Huw Pill told the House of Lords Economic Affairs Committee that the previous rounds of quantitative easing during the pandemic might have been a contributory factor to this upsurge in inflation. Is that what your assessment would suggest now?

Andrew Bailey: If you do not mind me saying so, Huw Pill prefaced his comments by saying that, with the benefit of hindsight, it is always possible to come up with a different path for monetary policy.

Q614 **Chair:** None of this could have been foreseen?

Andrew Bailey: No, hang on, let me finish. Huw Pill made the point that I just made about the scale of the Covid shock. He also made the point that, yes, QE did contribute, because of course that is what it was designed to do. It is a policy-loosening tool in that sense, but he made the point, and I think it is consistent with what both Catherine Mann and I have been saying about the shocks we are experiencing. That it was not a very big contribution. You have to bear in mind the "hindsight" point in which he made that comment. He was doing it deliberately with the

[1] The Bank added the following information: If there is uncertainty about the degree of inflation persistence, Angeloni, Coenen, and Smets (2003) "Persistence, the Transmission Mechanism and Robust Monetary Policy" and Coenen (2007) "Inflation Persistence and Robust Monetary Policy Design" find that it is better, from a robust control perspective, to assume a high degree of persistence. Relatedly, Söderström (2002) "Monetary Policy with Uncertain Parameters" shows in a (highly stylised) dynamic macroeconomic model that if there is uncertainty about the degree of intrinsic inflation persistence, it is optimal for policymakers to respond more aggressively to inflation in order to reduce uncertainty about the future path of inflation. Uncertainty about the future path would be reduced because any inflation not eliminated today could feed through into future inflation to an uncertain extent. For further discussion on the implication of uncertainty for monetary policymaking, see Mann (2022) "A Monetary Policymaker Faces Uncertainty".

benefit of hindsight that, as he said at the time, we do not have when we set policy.

Q615 **Chair:** We will go back to the labour market, as I promised we would, and then I want to ask Ben Broadbent a question before moving on to questions from colleagues.

The labour market point: it is clear now, isn't it, that we are in a wage-price spiral, that there is a lot of wage pressure out there? Could you share with us, Governor, how much you are going to be increasing pay at the Bank of England this year?

Andrew Bailey: We have not settled our pay round yet. We are still in the process of doing that so I cannot give you that number.

Q616 **Chair:** What are you proposing?

Andrew Bailey: You can observe that total economy pay is somewhat over 6%.

Q617 **Chair:** You are going to pay 6% more to your employees?

Andrew Bailey: No, I don't think we will be going there; no, we are not. I would also make the point that the mix of pay settlements has changed. We pick this up when we go around the country talking to businesses. More businesses are talking about using one-off payments, rather than permanent pay rises, and also directing their use of those pay components towards the low-paid. I can tell you that that is part of our approach towards what we are doing. We want to ensure that our lower-paid staff get more—a larger share—of the pay pots that we are offering this year, because that is the fair way to do it in the context of the situation we find ourselves in.

Q618 **Chair:** Will you be taking a pay rise this year?

Andrew Bailey: I am not going to take a pay rise. It is not for me to decide but, if I were offered one, I would not accept it. I would politely decline, as I have before.

Q619 **Chair:** Thank you, Governor. Quickly to Ben Broadbent: were these upside risks to inflation, and particularly with quantitative easing as well, subjects that the Monetary Policy Committee were discussing long before the invasion of Ukraine?

Dr Broadbent: Yes, of course. We do every time we meet. That is what we do. If I can make a couple of other points in relation to the earlier questions, just to ram home a couple of points about taking care with hindsight.

Just after that QE decision, the last one at the end of 2020, if you look at the consensus forecast, which is an average of 20 to 25 of the main forecasters of the UK economy, what they expected inflation to average during the course of 2022, so between one and two years later, was exactly 2%. In financial markets, where they spend a great deal of time as well, just like us, thinking what inflation will be, the figure for RPI inflation, priced into financial markets at that time, was just over 3%, so

consistent again given the spread between the two with a CPI inflation rate of 2%. That is the context. That was just after the QE decision.

It is fine to say, "After the event, this happened, that happened," but the fact that something happened that was not forecast does not mean that the forecast was wrong; it means that we live in a highly uncertain world. We have had these extraordinary shocks, bigger energy price shocks even than in the 1970s, and not just energy but food and not just energy and food but core goods after the pandemic as well. Therefore, we must be very careful to put ourselves in the position at the time.

Of course, every time we meet we discuss both upside and downside risks. The forecast is never meant to be a prediction of what will happen. It is precisely the point where you think the risk of being wrong on one side is more or less the same as the risk of being wrong on the other side. That is what a forecast is.

Q620 **Chair:** I would not be asking these questions if I had not in real time been asking about some of the inflation risks long before inflation jumped out of the box.

Dr Broadbent: The relevant point is that it was not a year ago. Given the lags in monetary policy, it was two years ago. If I had to think back and ask what we could have known better, certainly not Russia-Ukraine; not even the development of the labour market. As the Governor pointed out, at the time the furlough scheme came to an end, we were right at one end of that forecast. We were at the more hawkish end of the labour market forecast, and the UK has had this exceptional development, quite unlike any other country. Therefore, I do not think that that is the biggest contributor to inflation—I think it is relatively minor—or that it was forecastable.

The one area where I think all central banks, indeed all economic forecasters, given what I said about those numbers earlier, might have picked up earlier, were the inflationary effects of the pandemic via supply chains, where I would say that we did begin to see evidence in early 2021. However, as it happens, that particular source of inflation, the direct effects of it at least, do seem to have peaked now. We are seeing some evidence that core goods price inflation is declining, that shipping costs, computer-chip prices—all the things that were pushed up dramatically in the first half of 2021—are beginning to ease off.

At any one time you can find some people forecasting higher inflation than us and some people forecasting lower inflation than us. I think the relevant point is not a year ago; the relevant point, given the lags in monetary policy, is two years ago, and I am giving you the consensus forecast at the time.

Q621 **Chair:** I was worried about it, as the record will show. In terms of our constituents, who are all now suffering from this terrible, terrible inflation, can they feel confident that, with 3% as the base rate, you are going to be able to bring inflation back within the range that you are independently there to target?

Governor, as you answer that question—because in your previous evidence to us you have implied that you always do look at what is priced into the market, and we have just heard that from the Deputy Governor now—in your latest forward guidance to the market you gave a very strong steer that you thought the market was incorrectly pricing in forward interest rates. Can you talk us through your logic there?

Andrew Bailey: Let me answer that in two parts. There are two questions in there. Let me start with what we said. We said, "—should the economy evolve broadly in line with the latest monetary policy report projections" and that was the one we published very recently, "further increases in bank rate may be required for a sustainable return of inflation to target, albeit to a peak lower than priced into financial markets". That is the key sentence, to which both parts of your question refer.

Let me take the first part. We think that other things being equal, once we get through this winter—because of the way the gas price effects are going to work through this winter—there should be a quite pronounced fall in inflation thereafter. Our forecast brings it back to target and actually takes it below target, actually to zero in year 3. I will come back to that point because it is key for the second question.

However, you might ask why we are raising interest rates in that case and the however—the other things being equal—is that we also have the largest upside risk to inflation in the distribution of that chart in the history of the MPC, 25 years—it is about 0.5%. I should say that we do not construct the risks bottom up. We do not do it so it is a bit of this and a bit of that. We tend to do it top down and then attribute the broad story, and it is the one that we have been talking about already. We can all probably take slightly different views on how this works but, for me, it is predominantly the labour market and the risk of price setting and wage setting effects coming through from what is just a very tight labour market.

I was around the north of England last week and heard employers now beginning to say that they are seeing some reduction in competition for hiring. It is still a very tight labour market, as yesterday's labour market statistics demonstrated. It is very tight.

The reason that we said it is likely that we will be increasing interest rates further is that risk, notwithstanding the fact that the central case, the central projection, has inflation coming down rapidly.

By the way, the main reason inflation comes down rapidly in that case is arithmetic. As the annual effects of the energy price rises come out, inflation comes down quite quickly. That of course presumes that energy prices do not go up further. We can come back to that if you like because obviously there is some risk there, but that is the basis of the projection.

Now let me come on to the second part, which is the markets. We condition our forecasts on the market curve of interest rates. Just to illustrate this in terms of what the market has thought is going to be the

peak of our interest-rate-rise cycle, back in August, when we published the August Monetary Policy Report, the market was predicting 3% as the peak, which obviously we are now at. By the end of September, that number had gone up to 6.2%. We will probably come back to the reasons why that happened. It is due to a lot of the things that were going on.

By the time we did the forecast for the November MPR—and we cut the forecast off in the later part of October—that number was down to 5.2%. Today, it is 4.6%. We had 5.2% in there for the forecast. When we look at the profile of inflation that that generates, it brings it down to zero in the third year, a bit below target at the end of the second year. Our view was that that profile had a curve that was higher than was consistent with our view on the likely path.

You may want to say, "It is down to 4.6% now, so what do you think about that?" However, we do not have a precise set of numbers. It is not that we have a precise set of numbers, but it is clearly lower than it was when we did the forecast.

My final point is we do not push against markets lightly. We rarely do it, frankly, but we knew the story behind why it was. Let's be honest; there was something of a UK risk premium built into the markets—I gave that 3%, 6.2%, 5.2%, 4.6% profile—and we felt that was too high a profile and it was not consistent with what we think is the most likely thing. That is why we did it.

Q622 **Chair:** How much is the UK risk premium today?

Andrew Bailey: It's hard to tell. I would say in the markets, most of it has come out. If you look at—

Chair: It is not zero, though.

Andrew Bailey: It is not probably back to zero. One way of looking at this is to look at the evolution of the UK curve, the euro area curve and the US curve since the beginning of August. I think we have published those charts. You can see the UK premium. They have come back—

Q623 **Chair:** What is it today?

Andrew Bailey: They are fairly aligned again today in terms of tracking the movement, not the levels—the levels are different—but the movement since the beginning of August. A lot of it has come out, in other words.

Chair: Thank you. I am going to hand over to Anthony Browne.

Q624 **Anthony Browne:** My initial questions are going to be about the economic outlook. You predicted in the Monetary Policy Report a recession that was not as deep, I think, as previous recessions in the latter half of the 20th century but possibly longer. How much uncertainty is there around that? There is lots of speculation about how long and how deep it is going to be, but could you describe what you think the outer limits are and say if there is any chance that we are going to avoid a recession?

Andrew Bailey: I am sure my colleagues will want to come in but I think it goes back to the point of the previous question. In part the uncertainty around this reflects the impact of the tightening of financial conditions between the August and November Monetary Policy Reports. That is why, in the presentation of the November Monetary Policy Report, we put rather more emphasis on the other forecast—the so-called constant rate forecast, than we normally do. Let me be clear that that was not because we do not think—and I read the language out a few minutes ago—that rates are going to most likely go up again, but because it is a useful set of rails to see the margin it generates.

Just to give you the story on the recession, I can do that in terms of the level, the shift in the level, of GDP. Peak to trough for the market profile, it is a negative 3%, and for the constant rate it was just—

Anthony Browne: For GDP?

Andrew Bailey: Yes, and peak to trough for the constant rate is just under 2%. Don't get me wrong, any recession is a bad recession but they are not deep recessions by historical standards and the constant rate one is even shallower. I hope that gives you a sense of at least two rails that you can put in to help to make a judgment on this.

Q625 **Anthony Browne:** Compared to previous recessions, as I understand your graphs, you are predicting that it will be quite long, more than most, and it will go through to 2023-24. Why do you think it will be so prolonged? I think Ben Broadbent is keen to get in.

Dr Broadbent: All I was going to say is, first, to emphasise the point Andrew Bailey just made. That is to always remember that the interest-rate curve, on which we are conditioning these forecasts, was significantly higher even a couple of weeks ago than it is today.

The other thing is the general point that there is generally a huge amount of uncertainty about this forecast and in particular, on the central profile, that in the last two or three quarters of that recession, the projected decline in GDP, is pretty small. It would not take much of a tilt to shave a couple of quarters off the projected length of the recession, so I would not stand squarely behind the length and say this will definitely happen. I think it could quite easily turn out to be a little bit shorter or a little bit longer.

On the constant rate forecast, there is still a recession in the forecast and I should say that a lot of it, a lot of the weakness—there is some underlying weakness in supply and the trend growth rate against which we are judging things is not itself very high—but also the effects of these energy and food-price shocks and in general the rise in import prices, which lie behind the hit to real incomes, are already taking a big toll.

One thing I might point out, with respect to the earlier conversation, is that what is making people worse off—that spread between wages and price growth, wage growth and price inflation—is directly the impact of these higher import prices, and it is inescapable. That is what is driving the weakness right now.

As you go through the forecast, certainly the one we did in November, which had further steep rises in interest rates, more of the weakness is due to the tightness of financial conditions and, indeed, monetary tightening. I think what we are getting right now—and we could well be in another quarter of contraction right now—is the result of something that has already happened. Obviously, one is more certain about the near term than the medium term but further out there is a lot of uncertainty, including about the length, I would say.

I don't know if anyone else wants to come in. Swati Dhingra, Catherine Mann?

Dr Mann: Basically, what we buy from abroad costs a lot more.

Anthony Browne: We are poorer.

Dr Mann: That makes us poorer and monetary policy cannot offset that.

Anthony Browne: That is a point that I have made to many people.

Dr Mann: It doesn't make it any better.

Q626 **Anthony Browne:** Ben, you touched on some of the distribution impacts. Are there particular groups of people in society who you think will bear the brunt of the recession? Is it going to be more difficult for some people? Middle-income people have built up a lot of savings. They probably have a bit more of a cushion.

Dr Broadbent: The better off have, and traditionally—I say "traditionally" but it is not the right word—historically on average recessions are regressive. It is the less well-paid who are more likely to lose jobs in a downturn and of course these huge rises in import prices happen to be in areas that form a larger part of consumption baskets for less well-off people: energy and food, so that is making a difference as well.

This morning I looked at the numbers for producer prices, which come out alongside consumer price numbers. The number for imported food prices is up, I think, 30% year-on-year. That gives you some idea of the pressures that are coming through.

The only thing that goes against that is maybe there are differences in the distribution of wage growth and some of those may be stronger at the lower end. However, you are right that in general recessions are regressive and the particular rises we are getting in import prices—

Anthony Browne: The vulnerable are going to be particularly badly hit.

Andrew Bailey: To give you an example, based on this morning's inflation number our staff calculated that based on the consumption baskets—taking the income-distribution deciles—for the ninth decile, which is top but one, the inflation rate was 10.5% but for the second decile, the bottom but one, it was 11.9%. That shows you there.

Dr Mann: Keep in mind as well that people at the top end of the distribution are not spending their full salary, so inflation is not affecting their full income.

Dr Broadbent: They have a lot more. They are just going to save less each month.

Dr Dhingra: I will add one more demographic group, which is younger individuals. Typically the ones who enter the labour market in a recessionary environment are the ones who end up with perpetually lower wages. That risk is pretty strong as well here.

Q627 **Anthony Browne:** I have a question for Swati Dhingra. You have been at the dovish end of rate rises. You were in a minority, voting for a 0.5% increase rather than 0.75% last time round and in earlier times. Why do you think you have a different judgment on that inflation expectation from others? Why are you more optimistic or less pessimistic?

Dr Dhingra: Let me start by reiterating the point that I am a trade economist and I take that very seriously in terms of what the terms of trade shock imply. It is going to show up as us being poorer, either in terms of lower profits, lower, real wages, or higher prices, which means consumers end up suffering. That is just a reality that we are going to have to face up to; that we are just poorer and there is no solution to that from monetary policy.

On the other element, which is: should I have voted higher or lower? I can explain to you what determined why I voted for 25 basis points in the first case and 50 basis points in the second case.

The main point was that by November it was quite apparent that not only had the economy slowed but it was already in negative territory. This is one way of thinking about the constant rate projection, which the Governor has emphasised, as well about the market expected curve. You could think of getting into a much deeper, much longer recession if rates continue to rise because there is already a fairly sizeable chunk of the previous rate rises that still have to take effect in terms of what they do to GDP. There are also the inflationary impacts, which have not fully manifested. In that sense, at this point now, there is a sense in which with rates being higher than where we stood say a year ago, there is a risk of over-tightening.

That is the thing that I am worried about at this point, although I completely take the view that, yes, inflation expectations are high. Quite often they are very influenced by the spot inflation rates so, in that sense, they are not simply a measure of inflation expectations. They take into account what is the salient thing that people are seeing. Energy prices, of course, are very salient.

Those were my concerns and I did not find enough of a reason to have a very forceful action because some of the base effects were still there in the September numbers. There was then subsequently some more increase in services producer price indices, even though energy prices

were not rising and that led me to move a bit to the higher end of the spectrum.

Q628 **Anthony Browne:** Finally, on international comparisons, various journalists have pointed out that we are the only G7 country where the economy is currently contracting and yet there are also forecasts that the Government repeats—I think from the IMF—that we are going to be the fastest growing economy in the G7 this year, or at least that was the projection recently.

How do you see us comparing internationally? Is our economic outlook more troubling than in other comparable countries and if so, why?

Andrew Bailey: We may all look at different particular indicators for this. I will tell you mine, and that is the level of UK GDP now versus the pre-Covid level compared to other economies. I am afraid it is not a good story that I am about to tell you.

I think the UK level is minus 0.7. In other words, the economy is smaller than it was at the end of 2019 in terms of GDP. The euro area is plus 2.1, and on the latest number, which has just come in, the US is plus 4.2.

Q629 **Anthony Browne:** What accounts for that difference? That is a dramatic difference.

Andrew Bailey: It is a dramatic difference and I think there are probably quite a few things that account for it.

The approach that has been taken towards energy prices, fiscal support—the US has had a lot of fiscal support; the US is in a very different position in terms of the economy—there are probably quite a lot of things contributing to the difference but for me it is pretty striking.

Dr Broadbent: Including, as Andrew said earlier, the labour force.

Andrew Bailey: The labour force is part of it.

Dr Broadbent: If you look at the higher frequency indicators, things like the BMI surveys, which are good measures of growth, what stands out is the US more than us. European trends are very similar to those in the UK because the big shock has been gas prices and the US has escaped that.

Dr Mann: Wage dynamics are different, though, between the UK and euro area; wage dynamics are different. It does come back to labour force participation. In the UK, it is a dramatic outlier compared to all of the other advanced economies. This is a puzzle. It is a puzzle because, in principle, with higher wages being offered—even if not as high as price inflation—that would tend to bring people back into work. Similarly, if you look at it through the other lens, if people are not in the labour force and are not working, how are they managing given the inflationary environment of their pocketbook? That is a very significant puzzle.

Anthony Browne: I would love to ask some questions about that sometime.

Q630 **Rushanara Ali:** I have questions about the future path of inflation but,

first, I want to ask a couple of follow-up questions in relation to the point about a prolonged recession that I think Ben was talking about.

Do I take it from you are saying that we should expect this recession to be prolonged and deep? Or is it going to be shallow? The Chancellor has talked about "shallower". He is trying to have a softer landing but, from what you are saying, it sounds like it could be something quite different.

Dr Broadbent: The central forecast at least is slightly shallower than others, and slightly longer, but I am not sure how confident I can be of either of those. If you look at our central path, certainly the length, I don't think one should emphasise too much because the profile is almost flat. It is just declining in the latter part of that projected recession. On the other hand, it seems likely—we do not know and we will not find out for three months or so—that by the end of this year we could well have had already two quarters of negative growth.

What matters for us in the projections is more the growth relative to the trend in the economy. By those standards, it is not particularly, in the forecast at least, that deep a recession.

Q631 **Rushanara Ali:** If it is not that deep a recession, for instance, could you talk us through what you expect unemployment levels to be? We talked about a tight labour market but there will be some unemployment. How bad is it likely to be? Or is it likely to be less bad than before, although that is still bad?

Dr Broadbent: Again one has to take care. Looking at a forecast conditioned on the steep rises in interest rates at the time of the November report, the unemployment numbers go to 6%. In the central forecast, it could be higher or it could be lower. I cannot remember what the peak is in the constant rate.

Andrew Bailey: It is 5%, 5.1%.

Dr Broadbent: There is some rise but it is not, say, the rise in the recession of the early 1990s where unemployment went up to a lot higher.

Andrew Bailey: If you do not mind my coming in, I think there is also another interesting question here. When I go around with our regional agents, the labour market is the number one story that firms want to talk about and it has been for a while.

I was in the north-east and the north-west last week. Firms are still talking about how it is so difficult to hire labour now that we are not going to get rid of them lightly, as it were. There will be a tendency to want to retain labour because of the difficulty of getting it.

Q632 **Rushanara Ali:** That will make it less of an issue in terms of migration, presumably?

Andrew Bailey: It could push down on the rise of unemployment, that is the point.

Rushanara Ali: The demand.

Andrew Bailey: It would then probably transfer into somewhat lower profits for firms.

Rushanara Ali: Sorry, say that again?

Andrew Bailey: If you think about the labour share and the profit share, it would transfer some of that, through the recession, away and towards the labour share.

Q633 **Rushanara Ali:** Turning to the things you were saying about the UK risk premium, there are quite a few euphemisms being used about what happened between the end of August and the beginning of October. The numbers you were talking about in terms of interest—3% at the end of August and then up by 6.2 and now on to 4.6%—just to try to uncover some of this, can you tell us what the UK-specific elements were in terms of interest rates, the risk premium? You also mentioned 20% around inflation, and the upward trend in interest rates is not going to resolve the issue of the 80%. How effective do you think those tools are in terms of increases in interest rates? There are two sets of questions.

Andrew Bailey: The interest rate trends: we have a chart in the report that attempts to break down the contributors to the market interest rate profile between global shocks and UK shocks. You can see that into August it was all global. Then there is a UK contribution that comes in in quite a pronounced way.

Q634 **Rushanara Ali:** During the mini-budget period, just to be clear?

Andrew Bailey: Yes, in that period. That is now coming off.

Q635 **Rushanara Ali:** What amount was it that you can attribute to that UK-specific element connected to that event?

Andrew Bailey: At the maximum, it was about 170 to 180 basis points, according to this. All these decompositions are stylised of course. They are based on models. You have to understand that it is not a precise science.

By the way, when we did the 3%—and it is 4.6% now as I mentioned earlier—if you look at the euro area and the US, they have all gone up. It is not that we still have 1.6% of UK risk premium left in. It has gone up for the euro area and the US.

Q636 **Rushanara Ali:** Sure, but taking that into account, what is the UK element?

Andrew Bailey: Now?

Rushanara Ali: Yes.

Andrew Bailey: It is coming down. We do not have an up to date decomposition of this sort but I would say that now, in terms of the differential between our movement and the US and euro area, it has come down a lot.

Dr Broadbent: One other way to judge this, look at the currency. At the time of the August report, I think sterling/dollar was, say, 1.19, £1 was worth $1.19. At the low, that fell to 1.03 and it is now 1.19 again.

Andrew Bailey: That is this morning again.

Rushanara Ali: So the cost of imports during that time, given—

Dr Mann: That is a really short period of time—contracts would have been made—but 20% down from the beginning of the year does translate into an inflationary effect, and 40% of food is imported, for example, so you can see how you have a depreciation passing through that channel.

Andrew Bailey: If I could also add this. We have talked about prices and markets, but there was a second element to this, that we had very, very illiquid markets and very volatile markets in the sense that they were not trading well.

Q637 **Rushanara Ali:** You mentioned earlier, to the Chair's question, a sequence of shocks—Covid, supply chain shocks and Russia and so on. I am going to bring the B-word in again because we have not talked about it for a long time. We all know that it is 4.5%—before the Brexiteers join the Committee; there are a few, I am sure, who will join us—the point is a 4% hit on GDP in the long term, and I wonder if you can comment on that. The former MPC member, Michael Saunders, said this week if we had not had Brexit we probably would not be looking at having an austerity budget this week. What do you make of these comments, and do you agree that there is self-harm done to our economy and these shocks that we have had since have made us more vulnerable than other economies?

Andrew Bailey: We have talked about this a lot of times before. I think the Bank's assessment—and we use this in the forecasts on the Brexit impact—really has not changed since the work that was done previously.

Q638 **Rushanara Ali:** Does it not in effect compound the problem?

Andrew Bailey: This work was done pretty soon after the referendum. It essentially assumes that there is a long-run downshift in the level of productivity of a bit over 3%, and that at least two of those come fairly well forward in the timeframe. It is fair to say I do not think anything we have seen so far changes our view on that. We have not changed our view on that so far. There is an effect. We have not been surprised by that. I think it is for Michael to take his own view.

Q639 **Rushanara Ali:** He is a liberated man now.

Andrew Bailey: You said it. My approach has always been that as a public official I am neutral on Brexit, per se, but I am not neutral in saying these are what we think are the most likely economic effects of it. Swati Dhingra is a great expert on this subject.

Dr Dhingra: I can come in on that. Clearly, I have written a lot about it. I am not going to talk about the political choice that was made. I am going to talk about the economic impacts.

Q640 **Rushanara Ali:** The implications are what I am interested in.

Dr Dhingra: It is undeniable now that we are seeing a much bigger slowdown in trade in the UK compared to the rest of the world. That is showing up despite the statistics having been much worse than they used to be, there being a discontinuity, but people have tried to do various ways of correcting for those things.

There is also the services export side, which we do not have very many contaminated statistics for, so I can say that much more confidently, that there again we are seeing a strong stagnation.

We are definitely performing below trend in terms of the export numbers, in terms of the imports probably even a bit bigger than that. The simple way of thinking about what Brexit has done to the economy is that in the period that happened after the referendum, the biggest depreciation that any of the world's four major economies have seen overnight, that contributed to increasing prices, reduced wages, and I am not simply talking through real wages but also through nominal wages. We think that number is about 2.6% below the trend that real wages would have been on. Soon afterwards and before the TCA happened came the effects of the uncertainty that was unleashed, which basically translates into reduced business investment. I'm less certain of the FDI effects – those tend to be very lumpy things.

Then what is happening now is we are starting to see the trade numbers react to the Brexit actual TCA impact and that is what I mentioned in the beginning, that we are definitely underperforming compared to our peers, both in terms of what we are sending to the EU as well as in terms of what we are sending to the rest of the world.

Dr Mann: I would like to add on to this because I look at a lot of firm level data and the small firms are the ones that are the most damaged, because the cost of the paperwork and so forth is a barrier. It is not just small firms in the UK who want to export, but it is also small firms in Europe who were suppliers and provided competition in the UK market. There is an inflationary effect coming through the competition channel.

Q641 **Rushanara Ali:** Do you have a sense of what the inflationary effect amount is, relating to trade with the EU and friction in both directions?

Dr Mann: I am not going to hazard a guess on that.

Dr Dhingra: I can talk about the food price effects. Some excellent students at LSE have done this work, that about 6% is the number that is higher than the rest of the world, as a result of the Brexit impact.

Q642 **Rushanara Ali:** That is really interesting.

Dr Broadbent: Right now, the inflation rates are pretty close. We had 11.1% in October and the euro area is 10.7% so the timing of these effects is hard to gauge. As Andrew said, we have seen no reason to row back from the estimate we had on the overall impact on real GDP, which is what matters for real incomes.

Q643 **Rushanara Ali:** Going back to Michael Saunders, we would probably not

be looking at an austerity budget this week? You cannot comment on that? Fair enough.

One last question, which is about peak inflation. Have we reached it? You talk about it going down in the middle of next year. Should we expect it to continue to rise, given where we are in the ONS data?

Dr Broadbent: I think our forecast is pretty much flat around this level for another three months. Maybe it edges down a bit in the first quarter, in the central projection, but it is really when these base effects on energy kick in, in the spring, that you start to see the material difference.

Andrew Bailey: The energy effect of course is now capped until effectively April. Looking at this morning's number and going back to what Swati Dhingra was saying as well, food is the area to particularly watch for. Looking at this morning's number, it was not much higher than we expected and we have said consistently it is going to be around 11%. In fact, I think it was 0.15% above where we thought it would be but, looking at the components, food was the other thing that contributed.

Q644 **Siobhain McDonagh:** I want to look at the impact of recent developments on the housing and mortgage market, particularly the impact of the sharp increase in mortgage rates.

You note in the Monetary Policy Report there are particular uncertainties around the impact on consumption of recent and prospective developments in the mortgage market. Can you tell us more about the nature of these uncertainties and how they fed into your latest decision on the bank rate?

Andrew Bailey: Picking out a couple of things on that in terms of one is a bit longer term and the other is rather short term, longer term we have seen quite a switch, in the last decade we have seen quite a switch in the nature of the mortgage market in this country towards fixed rate mortgages. I think about 80% of UK mortgages are now fixed rate and around 20% is floating. I think if you go back 10 years it was certainly in the 60% region, a bit above 65%, so it has shifted. That was a progressive shift over time.

Having said that, I think our staff certainly when they do calculations suggest that by the end of next year something like 50% of mortgages will have repriced, so that is the variable rates, which of course will naturally reprice, and then those fixed rate mortgages that are coming up for new mortgages, new contracts. That affects a bit the transmission, but the mortgage market is still an important part of the transmission system.

That of course will as a result, and I have to be very frank here, increase the mortgage burden for households, for those households that are either on variable rate or coming up to a fixed reset. The scale for the fixed reset of course depends on what the pre-existing rate is compared to the current rate.

Now, coming to the short term, and this comes back to what we were talking about, the market movements over recent times, one of the

consequences of the shift to fixed rate mortgages is that fixed rate mortgages price off the market curve. They are not priced directly off our official rate, whereas variable rate mortgages are much more closely tied to our official rate.

What we saw during September, early October, again because of the effects on the curve and the instability of the curve was that that pricing was very difficult for mortgage lenders to do, so mortgages, you read all the articles, mortgages were being taken off the market because they were finding it hard to price and to offer a price for a period of time. That is the point. When you offer somebody a mortgage you give it to them for a period of time, and of course the price was going up.

We are now seeing again both of those elements settle down. There are more mortgage offers coming on to the market, and we are beginning to see now the price come down, because one of the points we make is that although we increased our rate by 75 basis points, that was fully priced into the market, into the curve. What we are seeing now is what we were talking about with this risk premium coming out, that new fixed mortgage rates are beginning to come down, which is what I would have expected to happen.

Q645 **Siobhain McDonagh:** Lenders were quick to increase mortgage rates following the mini-Budget on 23 September but have been slower to reduce them in line with falls in swap rates. Do you have messages for lenders about their approach?

Andrew Bailey: I have given them the message once or twice that this is what I would expect to see happen. Quite when it happens is a decision for lenders, because they have their own pricing arrangements. I would have been surprised and frankly disappointed if we had not seen this happen, and we are now seeing this happen, so that is what I would say in terms of fixed rate loans.

Q646 **Siobhain McDonagh:** How damaging was the mini-Budget for first time buyers in both the short and medium term? We had the major lenders in a few weeks ago, and while they completely agree with you that more products are coming back on to the market, they told us that the ones that are missing, or not coming back as quickly, are the high loan-to-value ones that specifically you would anticipate the first-time buyers would look at.

Andrew Bailey: Yes, and that is important. The lenders will be more cautious about those mortgages, because they are higher loan-to-value therefore they have a smaller slice of equity in them. That is not unusual to see that delay. Again, I would hope and expect that we will see that come away too.

To your point, if you were trying to get a mortgage during that period, a first-time buyer or second-time buyer, you were going to find it much more difficult. It was a very difficult period and we saw this obviously in a lot of press coverage of it, quite rightly.

Q647 **Siobhain McDonagh:** Do you think lenders acted fairly in the way they

withdrew loads of those products and offers? I have a particular constituency example that I have mentioned several times, of a young woman who hoped to buy on a shared ownership basis, only to have the offer withdrawn just after the mini-Budget and then several days later to come back with an interest rate about 2% higher.

Andrew Bailey: I hope you will understand I cannot comment on any individual cases. That is not possible. What I would say is that it was very difficult for the lenders to price mortgages, when the curve was so unstable. That is the problem.

Q648 **Siobhain McDonagh:** That instability was directly because of the mini-Budget?

Andrew Bailey: We were in a very unstable period, yes.

Q649 **Siobhain McDonagh:** Many market commentators are predicting falls in house prices over the coming year. I think the gentleman from the Nationwide was looking at between 8% and 15% but out on his extreme end he did consider 30%. I appreciate that is a very large number, but what does the Monetary Policy Committee expect to happen to house prices over the next year?

Andrew Bailey: We do not directly forecast house prices, however two things I will add, and colleagues can come in. First, some of the parts of the story that we have talked quite a lot about already this afternoon, so obviously the real income shock, the prospect of recession, the fact that we have wages that are in real terms not increasing, all those things will have an impact.

Secondly, if we look at quite a lot of housing market indicators, I think they are all now showing a weakening, both the activity and the price numbers. I say "weakening" and particularly on the price numbers, it is more a weakening of the rate of growth. There was a series published this morning that was almost flat and had come off further, and I think that was the weakest for a year or more. The volume numbers, so the number of transactions, have also weakened. We are seeing that, certainly.

Q650 **Siobhain McDonagh:** What impact would price falls have on consumption and inflation?

Andrew Bailey: It depends on the cause of them. As I say, it is not necessarily price falls. The other thing you must look at is loan-to-income ratios, for instance and debt servicing ratios. Obviously one of the consequences of us tightening monetary policy is that debt servicing ratios are going up and it is also quite possible that even if in real terms house prices do not rise, they do not rise in nominal or real terms, you then must relate those to whatever happens to earnings. Colleagues may want to come in on this. I would not look at house prices just on their own.

Dr Broadbent: As Andrew said, we do not have a separate forecast, but I would see it as part of the overall effect, for example, of tighter

monetary policy that has on consumption, rather than picking out the cause of house prices directly.

The other thing I would say is that as important in a typical cycle as those effects on consumption are what happens to housing investment, which is extremely volatile and extremely cyclical. It is the case, and this is in the report, that alongside falls in housing transactions we expect falls in housing investment, that is both spending on renovations and building of new houses.

Andrew Bailey: It is also worth saying, and Catherine and I were discussing this, coming from a US background it is quite different. The UK mortgage market is different, the housing contract is different in this country. You cannot walk away from houses as you can in the US. What we find, and this has fed a lot into the FPC's work on housing tools, is that consumers will prioritise mortgage servicing over other consumption. It is often the weakness in other consumption that shows up.

Dr Mann: When you were asking the question about the implication for consumption, it is very important to distinguish between a borrower who must refinance at a higher interest rate, because the term of their mortgage has run off and they have to refinance. It is a higher interest rate, which means they must pay more.

That has an implication for consumption because they are going to prioritise paying the higher mortgage. That is different from a house price fall for somebody who does not have to refinance. If we think of housing as a way of saving, if the price of it falls it looks like your savings are not as big as you hoped they would be, and so you may consume less because you want to build up these different types of savings, the housing savings and the bank deposit savings, but you do not have to do that. Whereas the—

Q651 **Siobhain McDonagh:** We can only hope that we can return to a time when we regard housing as somewhere to live. As you suggested earlier, you gave the proportions, only around 30% of households have a mortgage. Of those only one fifth are on floating rate and only a quarter are on fixed rate that will expire by the end of 2023. How much of the burden of fighting inflation is being borne by the minority of households?

Andrew Bailey: I think one of the impacts of the growth in the fixed rate mortgage system is that it does have differential impacts, therefore across households and depending on when your mortgage resets, as Catherine was saying.

Unlike the US our fixed rate periods are short, whereas in the US they are there for life. I am afraid there is a bit of luck of the distribution that comes into that, as to when your mortgage reprices versus the interest rate cycle.

Dr Broadbent: Monetary policy works through lots of channels. The cash flow effect that Catherine was talking about is important, but there are lots of other ways in which monetary policy affects inflation. I do not think we should imagine that it is only those people who have mortgages

or even among those only those who have had to reprice, who as you say bear the brunt of fighting inflation.

Dr Mann: For example, the buy-to-let market is another channel through which again—agreeing totally with Ben—there are many different channels for monetary policy but just focusing on this one associated with housing, the buy-to-let market the question is for those owners, landlords, when they reprice what happens? Do they pass on the higher cash flow obligations to their renters? That expands the pool of citizens and others who must pay for a higher cost of housing.

Andrew Bailey: Interestingly, we have seen rather more of a shrinkage of the buy-to-let market in the last year or so than certainly I had expected. That may be down to the tax system that has become more complicated, and so some of the people do not want to be bothered with it anymore. It has shrunk more than we would have expected.

Q652 **Chair:** Thank you so much, Siobhain, and on this important question of mortgages, because it matters so much to our constituents, you have moved the base rate from 0.1% to 3%, so inevitably mortgage rates have increased, so how much of the increase that you see in the mortgage market today has come from that independent decision by the Bank of England to tighten monetary policy and how much has been due to the disruption to the gilt market that we saw in September and early October?

Andrew Bailey: I think the September-October thing was obviously a short-lived thing.

Q653 **Chair:** Has that gone now?

Andrew Bailey: It is pretty much on the way to being gone. That was a thing that ran from, let us call it the beginning of September through to the middle of October. It did not disappear immediately, although some of it came off quite quickly. That is much shorter lived.

Q654 **Chair:** Therefore, we can send all our grumpy constituents about their increased mortgage rates in your direction, can we, Governor?

Andrew Bailey: Of course I would love you to send them somewhere else. Ours is a deliberate thing in that sense and I am afraid ours is the longer-run effect.

Q655 **Chair:** Of course, as Rushanara rightly says, except for the ones who had to fix during those five weeks.

Andrew Bailey: Indeed, and that is one of the problems as I was saying about the luck of the timing thing. You can be very unlucky in that respect.

Q656 **Rushanara Ali:** They should seek compensation from the former Chancellor and Prime Minister.

Andrew Bailey: That is for you.

Q657 **Alison Thewliss:** I have some questions around the fiscal policy and the relationship that you have had with the Treasury and the Government

about the previous mini-Budget and the upcoming one. I am not going to ask you to speculate on what we might see tomorrow, but—

Andrew Bailey: I do not know what is in tomorrow's statement.

Q658 **Alison Thewliss:** Sir Jon Cunliffe when he came to speak to us in October was quite clear that the Bank had not really been told very much about the contents of the mini-Budget. How much had you heard about that before it happened and what were communications like?

Andrew Bailey: Sir Jon was right. To put it into perspective we knew some of the statements that were made during the election campaign for the leadership of the party, but they do not translate into anything specific.

Beyond that, for two reasons it was unusually up in the air. The first one is that clearly, if I am honest with you—and I think this has been borne out by statements made by the former Prime Minister and the former Chancellor—it was just not clear what was going to be in this package. We did not have a clear steer on that. I should say, I think Treasury officials told us everything they knew, but this was a general thing, not specific to the Bank.

The second point I make, which is a very important point, is that because the OBR were not involved in it, we get a lot from the OBR in terms of the process, when they do a forecast, because they forecast out the spending and tax decisions, and we feed those OBR projections into our forecast as the means of taking fiscal policy into account. Even if we had known what was going to be in it, which we did not, in the absence of the OBR we would have been at a substantial disadvantage, because we would have had to try to do it ourselves, which we normally do not do.

Q659 **Alison Thewliss:** If you had known more details about it in advance would you have warned the Government about the path they were on?

Andrew Bailey: That is a bit hypothetical. I do talk to the Chancellor quite often but that is hypothetical.

Q660 **Alison Thewliss:** The most recent Chancellor has written to us saying that the Treasury provides the MPC with all relevant information so that you can execute your role effectively. Would you agree with that?

Andrew Bailey: Absolutely. It is a very strong relationship and has been throughout the life of the MPC. It is very well set out and developed, so there is no problem with the relationship with the Treasury.

Q661 **Alison Thewliss:** The Energy Price Guarantee will be a major determinant of the MPC's next forecast and interest decision. Did the uncertainty over the scheme's replacement from next April affect your November decision? You mentioned energy prices being an important impact on where you are going with this.

Andrew Bailey: I will describe how we went about that. It was a rather different situation in that case. As you say, clearly we knew the picture from now until April, so we were able to put that in. Just to say the approach we take is we condition our forecast on "announced fiscal

policy" so we had to think hard about what the word "announced" means in this context.

What the current Chancellor had said is that he was not going to announce what he was going to do after April but I think I am right in using these words, that there would be a more targeted policy. If I can describe the two bookends to this, one bookend would be that he was going to continue with the previous Chancellor's policy and the second bookend would be nothing. I think both of those were explicitly ruled out by what he said.

We could not default to either of those, so we made a stylised assumption of interpreting what he had said, and that was basically to take the futures curve for gas, and I will use gas as that is the easiest one, and then essentially map that into what we thought would be an Ofgem cap and take basically halfway between the full level of the full policy as announced from now to April, and what that would buy.

I think I am right in saying that one end of it would have been £4,500 as an average annual subsidy and on the other end about £2,500, and I think our number was about £3,400, that is midway through. We then projected that forward for the remaining life. That is how we did it. That is based on no inside knowledge of what the Chancellor is planning to do. It is what I call a stylised assumption.

Q662 **Alison Thewliss:** That makes sense. You have to go on the basis of the information that you have.

Cornwall Insight put the estimated cap at £3,702, which is slightly higher than where you are forecasting.

Andrew Bailey: For their halfway house?

Q663 **Alison Thewliss:** Yes, for their estimation of where the cap will end up.

Andrew Bailey: I would have to look at that, because as I say there is a futures market price in there, so you could get different numbers at different points in time quite easily. That curve moves quite a lot.

Q664 **Alison Thewliss:** What the Chancellor told me yesterday was that energy price support we give to families will not end next April, which does not seem particularly wide. What impact would it have on your decision making if the support was quite narrowly targeted, therefore other households would pay significantly more? What impact will that have on your decisions?

Andrew Bailey: Again, there is more than one part to this. There is the inflation part to it, in other words, what does it do for the path of inflation? Then there is also the demand side, because relative to the counterfactual, so relative to the August MPR when there was nothing in there, of course these sorts of fiscal measures do inject demand into the economy relative to that, so we have to factor both in.

Dr Mann: The way I would like to think about this is that there is a mechanical effect of the cap on the CPI. We can look at that and we can change it, but what is more important is that what the cap does is it

provides a strategy whereby instead of paying a lot for energy or for gas, people will pay less than what the futures curve would suggest. Then they rotate that extra purchasing power towards other goods and services, and how much rotation there is depends on what the programme looks like.

It also depends on what the deciles of income are, to how targeted it is. If it is not targeted at all, and everybody gets it, then you get one impact. If it is very targeted towards the end you get a different impact. It is this rotation towards spending on other goods and services that is the important behavioural response, and that is something that is more difficult to calculate. We know it is there and so we do incorporate that qualitatively into our assessment of inflation.

Q665 **Alison Thewliss:** That makes sense. Is there a different impact on inflation because there is no cap on businesses?

Dr Broadbent: There is a different impact on inflation probably, the ONS are the arbiters of this, if it is targeted, possibly. These two effects that Andrew and Catherine have been talking about, one directly on CPI inflation and the other on demand, the demand effect is predominantly what is the size of the package, compared with what otherwise would have happened and that has some positive effect on demand and future inflation, all else equal.

The direct effect on the CPI depends on how the ONS interprets such support. There was some support before August, targeted. That did not affect consumer price inflation, it did not help reduce it. What came in in August did, which is why alarmingly high though it is, the figure of inflation today would have been higher in the absence of that.

A more targeted scheme the ONS may not count as affecting prices. That targeting could have some bearing on any direct effects on inflation. Businesses I think we would treat in the way that we normally treat fiscal transfers of that sort.

Q666 **Alison Thewliss:** Some of the businesses that I have heard from are having to buy into what I would consider are impossibly expensive contracts, which they are shielded from just now but will not be shielded from later. What impact would that have on the decisions that you have to make?

Dr Broadbent: I think it will go into the forecast for demand. This is a macroeconomic forecast, so we do not, except in some areas, go much below the surface. I think it would be treated as an ongoing effect of higher energy prices on real demand in the economy. You are absolutely right that some of these are quite long-term contracts and just as we were talking about earlier with the mortgages, there are companies that are rolling off what compared with the spot price today have been relatively low costs.

Dr Mann: Our decision-maker panel asks firms how they reacted to different costs, and energy costs are one of the things that they believe they can pass through, unlike some other costs where they feel that it is

more difficult to pass through those costs into prices. To the extent that the cost structure of energy continues to be upward sloping, that puts additional pressure on firms to either raise their prices or reduce their margins.

One of the observations that we have right now is in fact the futures price is quite downward sloping. Going back to what Ben said, if you can wait and not sign a contract today that is a strategic decision for an individual firm to make. Small firms can sometimes band together and work with a contract through that channel.

Q667 **Alison Thewliss:** To go back to some of the process stuff around tomorrow, originally tomorrow's fiscal event was going to be prior to you making a decision. Did the moving of that date have any problematic effect for the decisions that you were taking?

Andrew Bailey: Not really. I have described how we dealt with the energy price side of it. Everything that is going to come tomorrow is not in the MPR because when we conditionally announced the fiscal policy nothing was announced. We will take that on board first at our meeting in December and then in our next forecast for the February report.

Q668 **Alison Thewliss:** The mini-Budget was briefed by the Government as not being a major fiscal event. Do you regard tomorrow as a major fiscal event?

Andrew Bailey: First, the big difference is that the OBR are involved. I am not an expert in this field particularly, but I gather the term "fiscal event" is a bit of a term of art.

Dr Broadbent: The mini-Budget did turn out to be quite an event.

Q669 **Alison Thewliss:** It was not briefed as such, though.

Andrew Bailey: I am led to believe that when it is a Budget the OBR must be involved, according to the legislation. A fiscal event is this term of art that skirts around the legislation, if I can go that far in my comment.

Q670 **Alison Thewliss:** Finally, have you had much briefing on this one, and would you expect to have had?

Andrew Bailey: First, we are not in a monetary policy round at the moment, so we do not have any need to have briefing on any particular day of the week, because we are not meeting at the moment.

I saw the Chancellor last Friday, but we did not discuss what was going to be in the package and I think he was still working very hard on it. We shall wait and see. I do not know what is going to be in it, but that is fine. It is not a problem.

Q671 **Chair:** With Ben Broadbent, could the difference between stopping energy prices affecting the overall CPI and then helping households by paying direct into their bank accounts have an impact on monetary policy through lowering wage demands in this wage round? Do you see a difference in terms of those two approaches?

Dr Broadbent: Possibly. If we take the earlier example, we had both of these direct effects of lowering the CPI for a while and the peak in inflation, the level of inflation now, whether it turns out to peak or not would clearly have been higher without a scheme in place. At the same time, it supports demand as Andrew and Catherine described earlier.

In the forecast that we have had and the assessment of the Committee that second effect is bigger than the first, as far as medium-term inflation is concerned. You are right that one of the effects may be to temper the pass through from prices to wages and so forth. In our judgment the larger effect was on demand, and therefore the net effect on inflation forecasts in the medium term was positive, and that was one of the things that many Committee members cited in decisions to raise interest rates.

Q672 **Chair:** Governor, you mentioned a couple of times just now that you are meeting with the current Chancellor on a regular basis. Would you say the frequency is different from with previous Chancellors and how often should a Governor meet with a Chancellor to remain independent?

Andrew Bailey: I do not think independence is the point. We have many things across the whole scope of our activities that we talk about. The current Chancellor and I probably talk once a week or so. I think that is fine.

Q673 **Chair:** How does that compare to when the Prime Minister was Chancellor?

Andrew Bailey: To be honest, it is also a bit dependent on what is going on and the state of the world.

Q674 **Siobhain McDonagh:** Frequently, then?

Andrew Bailey: Hang on. When both of us were very new in our roles and when Covid broke we were talking daily, because frankly it was a crisis, clearly, and we were talking daily. In the normal sequence I think it is somewhat less frequent than that.

Q675 **Siobhain McDonagh:** We are not really used to normal just recently.

Andrew Bailey: Well, there are degrees of normality, or degrees of crisis.

Q676 **Chair:** Should our constituents want this to be happening less frequently?

Andrew Bailey: Let us be clear, I do not think independence depends on how often the Governor and the Chancellor talk to one another. It is a careful balance. Of course, independence depends upon well-established institutional settings, but I do think your constituents also ought to expect the two of us to make sure that we are appropriately in touch with each other. There are many things: we have to talk about regulation, for instance, and we have to talk about international issues, because we go to the same meetings.

Chair: That leads me right into Rushanara's next set of questions.

Q677 **Rushanara Ali:** Back to regulation, and the Financial Services and

Markets Bill. Given the decision by the Government that they will be able to directly regulate to make, amend or revoke laws where there are matters of significant public interest, and given that so far the Government have not defined what public interest is in their eyes, notably the Minister when he was here, are you concerned that this is a threat to the independence of regulators?

Andrew Bailey: I am concerned about it. I think we have had this discussion once before, but I am happy to develop the thought. Yes, I am. Let me start by saying there is a well-established division of responsibility. I hope you do not mind me treading on your toes for a moment. Parliament legislates, the Chancellor sends me remit letters every year describing how they interpret the remit, particularly in the light of their other policies. I think that works well. We as regulators operate the regime and you hold us to account. All these parts are important.

What I am concerned about is that I think this power muddies the division of responsibility and so I am not a supporter of it in that sense. I will come round to the point you made at the start, which is an important one. Let me say two things about the international situation.

There is a lot of talk about competitiveness. It is important to bear in mind that in an international financial centre, which is what we are, we are the world's leading international financial centre in many ways, part of competitiveness is having an effective legal system and part of it is having an effective regulatory system. I am not just saying this, because I would, wouldn't I? Firms will say this to you. It is not just me saying this. We must not threaten that.

Q678 **Rushanara Ali:** We have. Our Government have by breaching international law on other things.

Andrew Bailey: I am talking about the legal system here. The English common law system. It is interesting that wholesale financial activity generally takes place in common law systems, I am not saying English ones, but common law systems.

The other point I am making, and I have to go back to the last couple of months, we have damaged our reputation internationally.

Q679 **Rushanara Ali:** Because of the domestic issues in September?

Andrew Bailey: Because of what happened. As is well known, I was in Washington at the IMF annual meetings, which is one of the biggest events of the year internationally, the G7, the G20 and so on. We have damaged our reputation. People have said, "We did not think the UK would do this."

Q680 **Rushanara Ali:** Are you talking about the mini-Budget and the Truss—

Andrew Bailey: Yes, and it will take longer to rebuild that reputation than it will be to correct the gilt curve. We have to tread carefully.

Q681 **Rushanara Ali:** That damaged financial stability, so does this risk posing a risk to financial stability if it is interpreted in the way that was?

Andrew Bailey: If it is a power that is interpreted as going into our remit it muddies the waters. Here is the point because you made an interesting point at the beginning, and I want to pick up on it. Going back to four Chancellors ago, when the Prime Minister was Chancellor and the now Chief Secretary was Economic Secretary, when this discussion started, there was a discussion, to your point, about the public interest. I can see, because I have some experience and it was more when I was at the FCA than at the Bank of England, that there are issues that come up that are outside the remit of the regulator, which can be difficult to handle. National security is the best example. I am probably slightly treading on the toes of my former organisation here. We had a case, and I think it might have come up at this Committee, it did at one Committee, of a Russian listing, and people said, "Why have you not stepped in and stopped this?" and I had to say, "Look, it is a national security matter. We do not have a power." We should not. The FCA and the Bank of England cannot exercise national security.

There is an issue there, but that is explicitly outside the statutory remit of the regulator. That is saying what if there is a public interest issue that is not in your remit but is relevant? We could discuss that.

Q682 **Rushanara Ali:** Sure, but it would be helpful if the Government set out, laid out, what they mean by public interest.

Andrew Bailey: I have not seen.

Q683 **Rushanara Ali:** We have not either. So, you have not seen the draft amendment despite the fact that the Chancellor speaks to you regularly?

Andrew Bailey: To be honest with you I saw a skeleton of something four Chancellors ago.

Q684 **Rushanara Ali:** Four Chancellors ago? That is a very long time ago.

Andrew Bailey: That is not long. It was when the Prime Minister was Chancellor.

Q685 **Rushanara Ali:** Is it right that the current Chancellor, who is speaking to you weekly, is not addressing the very issue that could compromise your independence? Your institution's independence, as well as others.

Andrew Bailey: We will be discussing this. Obviously he has been quite focused on fiscal policy and that is important.

Q686 **Rushanara Ali:** This is important, for the reasons you have stated.

Andrew Bailey: It is, and we will discuss it.

Q687 **Rushanara Ali:** The reason I think it is so important, and I hope you agree, is that we need to understand what public interest is, because of course the Government can argue quite correctly that they have a democratic mandate but there are specific arrangements for regulators, correctly, for the reasons that you have said. What we know is that financial businesses or their lobbyists met Treasury Ministers nearly 200 times last year alone. In the same period Treasury Ministers met consumer organisations fewer than a dozen times. There is a clear

imbalance between the consumer interest and financial services and their interests and ability to lobby Government Ministers. My concern is that there is a risk that Ministers will come under political pressure and pressure from powerful lobby interests, and that could skew what public interest means and damage independence. We saw that example of the former Chancellors.

Andrew Bailey: Which one?

Q688 **Rushanara Ali:** The mini-Budget Chancellor, Kwasi Kwarteng. I was not sure if I should refer to him by name or his constituency but I am not in the Chamber. There were reports about him having meetings after the Budget with his former employers and so on. There are issues around the nature of the relationship between politicians, Ministers and other institutions.

Andrew Bailey: That is a very good point. That is why I set out at the beginning very deliberately what I think is this quite carefully constructed division of responsibilities, what you do, what we do, what Ministers do. It is a balance that seems to work effectively.

Of course, we are not democratically elected, and we must be very conscious of this, but the whole system is a democracy. It is not that one bit of it is a democracy, and the reason our accountability to you is so important is because it is part of our legitimacy as part of a democratic system. Sorry to sound pompous.

Q689 **Rushanara Ali:** If you were discussing the changes, what I am hearing is that there may be a necessity, but it needs to be very carefully defined around the points you made around national security or things that go outside the scope. It needs to be very clear and at the moment it is not, and we need to resolve that.

Andrew Bailey: Yes, to that point, and again it is not for me to say how this should be done, but I think Parliament I would hope when it debates that would consider what role as an institution Parliament plays in the whole legitimacy and accountability of that system, for the reason that you gave a few minutes ago, which I think is important, if that is the road we go down.

Because of the remit system, I do not think this is a necessary power within our remit.

Q690 **Rushanara Ali:** Do you think there is a general trend now? We heard some of it during the Conservative leadership campaign, and we have heard it among some parliamentarians, an assault, maybe that is too hard a word, on the independence of the Bank. Given that the rates are going up and the things that you have had to do, necessarily some would argue, and in some cases your response has had to be in relation to the mini-Budget, that the Bank can find itself being the fall guy because it is convenient politically for some people to do that. Of course, as you know, we have had exchanges where I have been critical at times of decisions that the FCA made under your rule and that is our prerogative to do so. Is there a risk that the Bank's independence is going to be under further

attack and assault because of the pressures and the things you are having to do? In the case of September, you had to respond, necessarily, but now because of the wider issues we have discussed earlier on, international dimensions as well as domestic dimensions?

Andrew Bailey: Our independence is absolutely paramount in my thinking and in the way I go about doing my role. I also am very clear, and I hope you do not mind me saying this, that if there was any threat to our independence, I would expect to tell this Committee that that was, in my view, the case. You are a very important part of this.

Q691 **Rushanara Ali:** I put it to you that this so-called public interest amendment, if it is not carefully defined, and the FCA, your former institution that you ran, the Chairman made it very clear that, like you have, internationally there is a real risk to anything that could undermine the independence of these institutions to our economic stability or financial stability. I would put it to you that given that the Chancellor meets you on a weekly basis this should be, perhaps not this week but next week, central.

Andrew Bailey: I think it is well known by Ministers what I think on this issue.

Q692 **Rushanara Ali:** Despite that, they do not seem to be making much progress on addressing these points. You discussed the draft amendment four Chancellors ago. Now, even before the mini-Budget chaos, should this not be a priority for Ministers to discuss this provision with you and other regulators, given the heads of your previous institution, Nikhil Rathi and the Chairman, Richard Lloyd, when he gave evidence, have made it explicitly clear they are concerned about it?

Andrew Bailey: Richard is very serious. I respect what he said, and I thought it was well put. This amendment has been promised to be introduced into Parliament for some time and it has not appeared yet. I have not seen it. Yes, of course I want to discuss it, but I have not seen it, frankly, and I do not know precisely why it has not been introduced into Parliament. I think that is a question you will have to ask Ministers.

Q693 **Rushanara Ali:** We have, and the Minister could not even define public interest and the issue here is that Parliament is being asked to allow Ministers to make those decisions around what public interest is. Parliament is being taken out of the equation as well, which is a real concern, because you rely on Parliament and this Committee in particular to highlight the importance of independence.

Andrew Bailey: Yes, and I rely on you to ask me what is going on and thereby we get the accountability.

Rushanara Ali: Yes, that is part of the problem here. I will stop here. We will raise it with the Chancellor when he is here next week as well. Thank you.

Chair: We certainly will. Thank you very much, Rushanara. Do you have your breath back, Emma? Emma has been asking a point of order in the main Chamber.

Q694 **Emma Hardy:** Thank you, Chair, and apologies for my absence for a while. Governor, if we could start with an interview you gave with Sky on 3 November, when you were asked about the impacts of the mini-Budget. You said, "that will have some lasting effects and we have to work very hard to put that in the past frankly". Could you elaborate on the lasting effects that it is having, and what the extra pain is that the UK is experiencing?

Andrew Bailey: I did not really answer that point. I started when you were out of the room, but I did not develop the point. We talked earlier with colleagues about the effect on the gilt curve and how that was coming out, but I then went on to talk about what I call the more lasting effects, which we have to work hard on. I made the point, as is well known, because I popped up occasionally, I was in Washington at the IMF annual meetings when a lot of this thing came to a climax.

I have to tell you, and I do not think this will come as a surprise, that the UK's reputation internationally has been affected by this. People have said to me that they did not expect this to happen in the UK, and I think we do have to work hard to rebuild the UK's reputation in this respect, because I am afraid it has taken a knock, in that sense. That is the lasting point.

We all have a part to play in this and we will do it.

Q695 **Emma Hardy:** Other than the reputational lasting effect, I know Catherine, your colleague, mentioned just before I left that the pound fell and therefore we are paying more for food, because we are importing food, and that is having an impact on inflation. Are there other lasting effects other than the potential impact on inflation from when the pound dropped?

Dr Broadbent: I think you heard earlier that most of the very dramatic effects on forward interest rates on the exchange rate around the time of the mini-Budget do seem to have dissipated. Now, whether that means the risks have gone entirely is hard to say, but certainly the measures that we have of that and, as Andrew said, the spread between our interest rates and those in continental Europe and the US, or as I said the currency, most of that has for the time being at least gone. There will be expectations in financial markets of tomorrow. I do not know what those are, but I imagine there is some expectation to do with fiscal sustainability. Markets will always pay attention to policymakers. The events at the end of September are a pretty stark illustration of that, but as far as we can tell, as things stand, most of it has gone.

Q696 **Emma Hardy:** Governor, do you think the UK experienced higher borrowing costs because of, and I am using your phrase, the UK-specific factors and to what extent are they persisting?

Andrew Bailey: It comes back to what Ben was saying. We may have said one or two things when you were out of the room, but yes, during that period there was a UK risk premium. If you baseline the UK-euro area and the US interest rate curves at the beginning of August and then

show the change in those curves you can see it. It is very easy to see during this period from roughly the middle of September through to the middle of October and then it starts to come off after that. Yes, you can see it.

Q697 **Emma Hardy:** Thinking of other UK-specific factors, we had some powerful evidence from Sanjay Raja, the Chief UK Economist at Deutsche Bank, in terms of our trade deficit, the UK's trade deficit and to what extent our trade deficit is having an impact. He said, "If you look across developed markets and emerging market economies, the narrow basic balance the UK has is extraordinary. It is one of the worst among developed and emerging market economies." To what extent is our trade deficit—

Andrew Bailey: Our trade economist can answer that. We have a real expert here.

Dr Dhingra: Apologies if I have said something before, in case I overlap. Broadly speaking, we are underperforming in terms of our exports, and of course that is going to show up in the current account deficit. We also know that with the currency depreciating, and I am talking about a longer run horizon, how much it has depreciated, that has also had a significant impact, which is that everything we buy is becoming more expensive and those things have a contractionary effect, not an expansionary effect. They are not increasing our exports.

That is a factor, but from a monetary policy point of view I can say that we are not exchange rate targeters or current account deficit targeters, and in that sense it can only be a consideration in terms of how it impacts economic activity and inflation, but not directly.

Q698 **Emma Hardy:** Why are we underperforming in our exports?

Dr Dhingra: Partly it is to do with the type of sectors we operate in, which did take a hit more than most in terms of the pandemic. More importantly, with Brexit happening there will be some level of impact that is coming through supply chains and whether you want to continue to locate in the UK or not. In terms of where you can see evidence of that, the best example I can give you is Canada did badly during the 2019-2021 period in terms of its openness, which was about a 4% drop in trade by GDP ratios. In the UK it is 8% and Canada is pretty much the worst out of that lot of countries. In that sense we are really underperforming compared to our peers, and of course trade agreements matter. That is showing up, the kind of sectors we operate in, that matters. The rotation towards goods versus services is particularly problematic for the UK because we are so reliant on services compared to other countries.

Q699 **Emma Hardy:** How has the fall in the value of the pound impacted inflation? Just to pick up on a point you made before, Catherine.

Dr Mann: With a 20% depreciation of sterling, that is the longer term, not the September event, then you get about another 10 points on inflation, so you do have a pass through.

Q700 **Chair:** Ten points as in 10%, or 0.1%?

Dr Mann: It is 0.1% if I am correct on that.

Q701 **Chair:** We want to clarify for the public watching.

Dr Broadbent: The exact number is not 10%, no, it is 0.1%.

Q702 **Chair:** Is it 0.1%?

Dr Broadbent: I think so. I cannot remember what shock you started with, Catherine.

Dr Mann: The 20% depreciation.

Dr Broadbent: I think it is 10%, from my memory.

Q703 **Chair:** The pound is up about 20% from the low today.

Dr Mann: We are talking say from January.

Q704 **Chair:** Yes. Since the beginning of the year, it has fallen about 20%. How much is that worth in terms of the inflation rate?

Dr Mann: It would be about 0.2%.[2]

Dr Broadbent: I am not sure it is 20% down trade weighted. I think it is less than that trade weighted.

Q705 **Chair:** We do expect you guys to know this statistic.

Dr Broadbent: Yes. It is not trade weighted, but I think Catherine is right, it is 10% on the trade weighted exchange rate. That will extend further for a second year. It does make a difference. It makes a much bigger difference in some areas than others, more tradeable things, goods, generally, food and so forth. Let us be clear that the big effects on import prices, on our real incomes, are not to do with that. They are to do with the pandemic and in particular the war by orders of magnitude. Look at the food price numbers. This morning I think they are up 14 from memory in the year to October. In the euro area they are up 13.1 or 13.2. They are very similar. That 14 is not because of the currency; it is because of the war.

Q706 **Emma Hardy:** What I am keen to understand is to what extent the depreciation in the value of the pound is impacting the prices and the inflation that people face. As the Governor said earlier on, and I thought it was a good point, about the difference the different percentiles feel in

[2] The Bank added the following information: To clarify, at its lowest point on 28 September 2022, Sterling had depreciated by about 20% vs. the US Dollar and 10% in trade-weighted terms since the start of the year. At the time of the hearing, Sterling stood at -12% and -5% respectively. There are multiple estimates of the elasticity of exchange rate pass-through to consumer prices in the literature and they are all affected by considerable uncertainty. In addition, exchange rate pass-through will depend on the underlying shock. The estimate cited by Catherine L. Mann is from Forbes, Hjortsoe, and Nenova (2018) "The Shocks Matter: Improving Our Estimates of Exchange Rate Pass- Through" who find that an exogenous depreciation of trade-weighted Sterling by 1% increases the level of CPI by 0.1% after two years. Such estimates are associated with significant uncertainty but applying this elasticity of 0.1 to the 5% depreciation in trade-weighted Sterling at the time of the hearing yields a level of CPI that is 0.5% higher at the end of 2024 than it would otherwise have been.

terms of inflation. We all recognise that the people on lower incomes feel inflation at a higher rate than those on higher incomes. What I would be keen to know—and do write if you do not have the figures now—is how the depreciation in the pound has impacted the inflation that is felt by some of the poorer people in our society, particularly when it comes to the price of food.

Andrew Bailey: It is an interesting point, given the impact on different income deciles. We could write to you on that.

Dr Broadbent: Yes, I think we should.

Q707 **Emma Hardy:** Because 0.2% sounds nothing to people on a higher income but what does that mean in terms of a basket of goods to someone on a low income?

Dr Broadbent: We share a lot of this inflation, because of where it has come from. There are very similar rates in continental Europe, which tells you that the currency is not the big story here, unfortunately. It is the war.

Q708 **Emma Hardy:** You have mentioned the war in Ukraine and the pandemic. What are the other main global factors impacting inflation at the moment?

Andrew Bailey: With the pandemic it is the supply chain consequence, which arose for a couple of reasons, which are related closely. One was the shift in demand from services to goods, which has pretty much gone back in this country. It has not so much in the US, interestingly. The second one was the supply chains themselves, China being an issue there, particularly in terms of the impact of the zero-Covid policy in China.

We saw that again this morning with the inflation number. The core goods numbers do seem to be now beginning to come off. You see that in the US as well. In the US inflation number earlier this week you see that as well. That shock is beginning to wear off, although I should say that I was at a large production plant in the north-east last week, which is a big user of microchips. They said it was still unreliable. It was at a point where they had had a good supply and now they were having to scale back production because they did not have the chip supply coming through, so it is still unreliable in that sense.

Q709 **Emma Hardy:** Other than Ukraine and the pandemic, are there any other global factors impacting inflation?

Andrew Bailey: There is obviously quite a different pattern. As Ben and others were saying, when you compare the US to Europe you do see a different pattern going on. The monetary policy challenge is therefore different. The US has a bigger demand shock element there. As I said earlier, the level of growth over the period since the beginning of Covid is larger in the US. Fiscal policy support was much larger.

Both the Trump and the Biden Administrations provided substantial fiscal policy support. Therefore, the Fed is much more in the position of having

to do the more traditional thing with monetary policy of having to push demand down and inflation down, whereas in Europe—and I use Europe geographically because we in the ECB have similar situations. We have a trade-off situation where activity is weakening but inflation is strong. Across the world there are different situations.

China is another part to the story. China's economy has weakened certainly this year, probably more than that. There may be several reasons for that. One is the Covid issue and the second one is some well-known financial stability weaknesses in the property sector. China has been weaker in that sense. There is a lot going on in the world economy; that is the big message here. Far more of the shocks that we are dealing with are global.

Q710 **Emma Hardy:** This is my final question. In what circumstances would you as a central bank intervene to prop up the pound?

Andrew Bailey: That has not been on our menu. Coincidentally, since 1992—we had the 30th anniversary of it a few weeks ago. I do remember it, sadly. That is not a policy tool that we entertain.

Emma Hardy: You would not intervene?

Andrew Bailey: I would not intervene in exchange markets; no. I am afraid it does not have a happy record in that sense.

Perhaps I could draw a distinction. It is a vastly different thing for a central bank to intervene in its own markets where we are the supplier of money. If you think about the gilt market intervention we did, it is very different from intervening in foreign exchange markets where obviously our firepower is limited. No, it does not have a good history.

Q711 **Chair:** Thank you very much, Emma. What I heard you say, Governor, is that we have a free-floating a currency and the Bank of England is not going to intervene on that.

Andrew Bailey: We take into account of the impact of that.

Q712 **Chair:** However, as you just said, you did intervene with the quantitative tightening that you announced at the Monetary Policy Committee in September and then of course you had to do the emergency intervention in the gilt market at the end of September. I want to ask very briefly about the Monetary Policy Committee angle, because we have heard evidence in the past that you are not sure how much quantitative tightening tightens monetary policy. Is that still the case or have you done some work on that and you now have an assessment, a rule of thumb for us?

Andrew Bailey: I will say two things on that and I am sure colleagues will want to come in. First of all, we always took the view—and we have done a lot of work on this as have other central banks; we have done particularly large amounts of work on it—that quantitative easing is state contingent in terms of its impact. It has more impact in periods where the environment is destabilised than it does in more normal environments. I do not see a reason not to think that it is symmetrical. I

say that because we obviously have a choice when we do quantitative tightening, but we have said that we will not be selling gilts into disorderly markets. That is why, by the way, we delayed the start of it. The point there is that we want to do this in an environment where it has the least impact.

Chair: In the short to medium term.

Andrew Bailey: It is not our tool of monetary policy. The Bank rate is the tool we are using.

Q713 **Chair:** Is it possible that the amount of quantitative tightening that you have announced means that you will have to raise the base rate by less? Is it possible that that is an outcome?

Andrew Bailey: The way I would look at that the impact of the announcement and indeed the execution of the quantitative tightening will be reflected through into market rates. Obviously we always take those into account. It will come through that way.

Q714 **Chair:** Ben, I know you want to come in. Could you explain how the Monetary Policy Committee was involved in the intervention at the end of September and to what extent you were directly involved, and the external members as well?

Dr Broadbent: I will take that first. I was involved as a Governor in those decisions. The MPC was informed. There are some very clear distinctions between this—

Chair: You did not approve it but you were informed of it?

Dr Broadbent: Indeed. There are some very clear distinctions between this and monetary policy. Let me come back to those in a moment. I want to deal first with the QE/QT point, the monetary side of the use of the balance sheet. Our estimates of what any policy lever does are always imprecise, but the particular point with QE was not that we were very uncertain so much as the point that Andrew made, that we thought the effects differed according to circumstance. When markets are very strained, a given amount of purchases will do a lot to bond yields and to interest rates. It has various effects on prices of financial assets, that's the way this balance sheet policy works.

There is no fixed multiplier and it would be misleading to provide one for that reason. It is not the case that a given number of pounds of purchases or sales of gilts from the APF does X to growth or inflation. As Andrew said, our approach now is it is in the forecast via the yield curves and prices of other financial assets on which we condition the forecast. That is the way that we tend to see it.

At a very high level let me now discuss the distinctions between the intervention in September and monetary policy. This effect on prices of financial assets is one way of seeing the difference. Monetary policy says, "Here's what's going on in the economy. In order to meet the inflation objective, given the forecasts—" as we discussed earlier, those forecasts

can turn out to be wrong "—this is what we would like interest rates to be, Bank rate and in the case of QE, yields further up".

Occasionally there are some financial disturbances. The dash for cash, for example, was one at the beginning of the pandemic. Very clearly what happened in late September was another. A financial intervention, and this is something that central banks have always done through history and it has not been seen as monetary policy, prevents yields from moving away from that preferred path. That is how I see that intervention in late September. As it happens, it was very much located in the long part of the gilts curve because that is where the LDIs hold gilts and pension funds.

The task was to prevent that from moving in such a way that would have serious destabilising and broad effects on the financial system and possibly ultimately on the economy. However, it was a very different kind of intervention from QE and QT. It was not designed actively to move yields to a different place, it was designed to prevent yields from being moved by some financial disturbance.

In that respect there were also operational differences. It was very much targeted at the long end, whereas QE and QT decisions are across the gilt curve. As we have said, it is temporary. Whereas QE decisions were in some sense indefinite, the MPC voted, "Here's the new stock" with no presumption as to what should happen to it, whereas this we have said would be temporary. We have recently announced how we intend to unwind the purchases made as part of that intervention. That has very, very different aspects. Whereas QE was done –, QT by contrast we want to be extremely smooth and predictable. The main instrument of monetary policy is now the Bank rate. I have gone on a bit.

Q715 **Chair:** Thank you, that was very informative. What I heard is that given that it is so state dependent, it is very hard to make ex-ante estimates of what quantitative tightening is doing in terms of monetary conditions.

Dr Broadbent: Yes, although, as I say, our view is that whatever it is doing, we can judge by the fact that it's passing through to forward interest rates. Let's suppose that our announcement of QT has had some effect. That effect would be transmitted via the yield curve, and we condition our forecasts on the yield curve. Therefore, to the extent that it is going to have a tightening effect on the economy and in time on inflation, that is taken to account in the forecast and therefore on the decision of Bank rate as well.

Q716 **Chair:** Also, what I wanted to ask is whether ex-post you will also publish your analysis of what you think it did.

Dr Broadbent: We have continually tried to refine our understanding of what asset purchases do and I have no doubt that we will do the same with asset sales.

Chair: That segues very nicely into the final section and then we will let you go and have a cup of tea.

Q717 **Anthony Browne:** Thank you. My questions are on the bond market. Bill Clinton, when he was first elected, a lot of his campaign promises were undermined by the international bond market not financing a lot of his things. James Carville, one of his advisors, famously said, "If I am reincarnated I want to come back as a bond market. You can intimidate everyone". Certainly, in this country we have learnt the power of bond markets. Were you surprised by the sharpness of the increase in gilt yields following the mini budget and the scale of the reaction?

Andrew Bailey: I think that Jon Cunliffe said this when he was here. Obviously the movements were unprecedented, certainly in modern times anyway. I can visualise the last 25 years and we do not see anything like that. Were we surprised? Yes, in the sense that when that sort of thing happens you do not sit there and say, "Yes, I thought that was going to happen". It was a very big move. I am sure historians and economists will come back and ask if it was large relative to the scale of the news. That is a judgment to be made but obviously it was a very big event. Given the answer to the earlier question, given that we did not know a lot about what was going to be in the statement, in that sense was this whole package of events a surprise? Yes, is the answer to that.

Q718 **Anthony Browne:** During the pandemic and afterwards there have been a lot of big announcements with fiscal consequences, if not a fiscal event. We have had the energy price guarantee scheme, for example, or the announcement of furlough. That was many tens of billions of pounds. The various schemes to support business all added up to €400 billion. However, they were not mostly accompanied by OBR reports or indeed bond market reactions in the same way. Do you have any thoughts about why this particular mini budget created such a large reaction when all the previous fiscally significant announcements did not have a market reaction in the same way?

Andrew Bailey: I have talked to quite a few people in the market as to what was it that you learnt that particularly created—for the reason you give. It is important for future Chancellors to know.

Anthony Browne: It is important for future Chancellors to know.

Andrew Bailey**:** Yes. There are two things that I will point to, one of which you have already referred to, which is the OBR. It was what I call the "flying blind" point, and thinking that that was okay to do. The second thing that was passed on to me, and this is an interesting one, was the significance of the top rate of tax announcement. I say that it is interesting because economically speaking that is not the biggest thing.

Anthony Browne*:* That was insignificant. It was £2 billion or something.

Andrew Bailey**:** These are not people who have a high marginal propensity—

Anthony Browne*:* Politically important but fiscally insignificant.

Andrew Bailey**:** The way people in the market put it to me was, "Is that the right thing to do in this situation?" What do you draw from that?

Dr Broadbent: That is a very good question. More generally if you look back over the hundreds of years for which we have data on bond yields and government debt and so forth, the correlation between those two is pretty low. I think that what matters a lot is the context and, as Andrew mentioned earlier, trust in international market and our institutional arrangements. There are various institutional things on which credibility of fiscal policy and monetary policy rest.

If you do two things together, if you do something to suggest that that somehow might threaten that credibility and at the same time you seek to go out and borrow a lot of money from that same market, it is the combination of those two things. I say this partly with the benefit of hindsight. It is not as if I predicted it.

Andrew Bailey: The other thing that I would add is the camp of believers, in what I call trickle-down economics of the early 1980s, is not a very large camp these days.

Dr Mann: The last point that I would add is that in comparison to the periods of time running up through Covid many, many different fiscal authorities were exploring strategies to cushion the blow and using many different strategies. What was different about September was being out there by yourself, whereas in the other cases you had a lot of company and a lot of fiscal authorities were doing many different things.

Dr Dhingra: Can I add one point to that? If you look at just the minute-by-minute data on either the exchange rate or the yields, there is not something that you can pinpoint and draw out that this was the one point where things tipped. Quite often in many other events you can.

Q719 **Anthony Browne:** Can I unpack the point that Ben made, slightly diplomatically? When you are talking about trust in the institutions, you are talking presumably about the attacks on the Bank of England that happened in the preceding months during the leadership campaign, and the dismissal of the Permanent Secretary of the Treasury and so on. The whole institutional structure seemed to come into play in a way that it had not been before.

Dr Broadbent: I do not know. That may have been possible. It is possible that it was the combination of those two things. As Swati said, to pin it down minute by minute is difficult, not least because then some of the dynamics in the financial system in these LDIs took over, which had their own extraordinary momentum, at least for a couple of days. That is my feeling about it.

Q720 **Anthony Browne:** Looking at a slightly bigger picture, do you think that that sudden instability in the gilt market—and the pensions issues that was a consequence of it—highlights or is a symptom of an underlying weakness in the UK economy and that if we did not have such big national debt or current account deficits and so on that the market would not have reacted so suddenly?

Dr Broadbent: It may be that a lot of things are adding together. We are not a reserve currency. The US would have more room to do these

things, I imagine. It may be that the overall balance sheet—although if you look at our net overseas assets they are not alarmingly low. There may be a number of contributory factors.

Andrew Bailey: We have, of course, seen fragility in other markets. The US Treasury market, which is one of the deepest markets in the world experienced this during the dash for cash, so it is not a uniquely British thing.

Jon Cunliffe discussed this when he was here. It does point to the issue that we know that we have and we have globally, which is why it is an important issue for the global Financial Stability Board. One of the things that we have seen since the financial crisis, and we should not be surprised at this, is that we have regulated the banking system and we have seen a relatively shift in intermediation to the non-banking system. It is quite pronounced when you look at it in global terms.

We are getting more things now blowing up in the non-bank world. The banking world, touch wood, has been rather more stable in that sense. We are seeing more things, whether it is crypto, whether it is LDI pensions or some issues around commodities. We are seeing this happen and we are thinking, both globally and domestically, and we have to think very hard about how we survey what is a very big landscape.

Q721 **Anthony Browne:** Going forwards, coming back to the response of the gilt market and the rise in yields, is there a risk there now that the Bank of England has to raise interest rates up more than it otherwise would have to, to ensure that it has credibility in the bond market?

Dr Broadbent: One of the ways to judge that is to think again about the currency. The MPC, we are all focused on inflation. Going right back to the beginning, we will do what is necessary to make sure that it comes back down to target, whatever that is. Had there been an ongoing effect on the currency and therefore on our inflation forecast, the result would have been a higher interest rate than would otherwise have been put in place, clearly, because that would have affected future inflation. As I said earlier, most of that seems to have gone so one cannot say that it is affecting our decisions right now. We are sensitive to it because the inflation forecast will be sensitive to it.

Q722 **Anthony Browne:** To be absolutely explicit, you do not think that the interest rates going forwards will be higher than they would otherwise been as a result of this mini budget?

Dr Broadbent: As we sit right here at whatever time it is, 4.00 pm today, we will see. The exchange rate does have, as Catherine said, an important bearing on our forecast. If that position were to change for whatever reason, then it would have bearing on future interest rates.

Anthony Browne: As it stands at the moment at 4.25 pm?

Dr Broadbent: Right now we are not meeting, so I cannot tell you want our next rate will be.

Dr Mann: There is a lesson to be learnt about that question with looking at what the yield curve was at the 6% peak, at the 5.25% when we had to make our forecast, at the 4.6%, where it is now. The lesson there is the market response has been to reduce the premium. That puts us in a different position with regard to our monetary policy, because when it was at 5.25% that is when we were looking at a deeper recession.

Chair: So do not go crazy tomorrow.

Dr Dhingra: I will say two important points with respect to that. One is that the volatility is now higher and the fact that we have seen the exchange rate dip to such a low level does put some level of risk on that. The second component of it is that it also makes it harder to make sense of the data and to really take stock of what is happening on the supply side and what the right rate should be. Those things become a lot harder when you had volatile episodes in the middle.

Andrew Bailey: I would add something to Catherine's point. There was a point, if my memory was right, when we were at 6.2%, when the market was expecting us to raise rates by about 140 basis points, 1.4% in one go. Obviously there was a period when they were expecting us to do an emergency meeting. Of course, we did raise interest rates by 75 basis points but my view at that time, when we were in the teeth of it, was that that level is too high—to Catherine's point about recession. You cannot solve a fiscal issue using monetary policy in that sense. Monetary policy has its role to play but that is going beyond it.

Q723 **Anthony Browne:** My last question is given what we have seen of the power of the bond markets in terms of UK domestic policy, would you like to be reincarnated as the bond market?

Andrew Bailey: It is difficult to get my head around what that would mean.

Anthony Browne: It means you can intimidate presidents and overrule governments.

Andrew Bailey: Have you ever met the bond market?

Anthony Browne: It means you can intimidate everyone. Those are all my questions, thank you.

Dr Mann: Having been at Citibank, the chief economist there, no, I do not want to be reincarnated as the bond market.

Q724 **Chair:** Thank you very much. Governor, since you mentioned crypto and we have had this inquiry going and there was an explosion last week with FTX, can you confirm for the public that there is no systemic risk to the UK from the collapse that we have seen?

Andrew Bailey: It is a better question for Nikhil Rathi than me these days. I can answer from the FPC perspective and give you a sense from the global Financial Stability Board. We are doing a lot of work on it. Our view generally is that it is not currently large enough to be systemic but it has the potential to be so. Therefore, the global FSB, of which I chair one

of the standing committees, is working very actively on crypto regulation, both in respect of stable coins and so-called unbacked.

I do not, to be clear because it is important to be clear on this point, detect what I would call a systemic fallout from FTX. Its activity in the UK as far as I am aware is not very substantial. By the way the FCA has refused a number of authorisations for these companies.

Chair: We still think there are constituents affected.

Andrew Bailey: There is ownership of cryptocurrency in this country, there is no doubt. I get asked about it, particularly when I go to schools, interestingly. How concentrated it is I am not so sure in this country. It is not something that we can be relaxed about and I can assure you that we are not relaxed about it. By the way, the legislation that is going through Parliament has a distinctive crypto regime.

Q725 **Chair:** As of today you do not feel that this is having systemic problems across the UK?

Andrew Bailey: No, I do not think that there is a systemic fallout from FTX in that sense but it is something that we are spending a lot of time on, particularly internationally. As you probably know I have been saying for at least the last four years that there is no intrinsic value in unbacked crypto.

Chair: Thank you, Governor, and thank you to the team. You have come in on an historic day when inflation is at 11.1%—the highest for 41 years—and our constituents are all relying on you making the right monetary policy decisions to get inflation back down to your target rate and to make those decisions independently. We understand that you are not making any comments today that are relevant to tomorrow. We appreciate you coming in on this occasion. We would like to thank you and the team.