

Treasury Committee

Oral evidence: Bank of England Monetary Policy Reports, HC 211

Tuesday 21 November 2023

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Members present: Harriett Baldwin (Chair); Mr John Baron; Dame Angela Eagle; Drew Hendry; Danny Kruger; Keir Mather; Siobhain McDonagh; Anne Marie Morris.

Questions 962 - 1059

Witnesses

I: Andrew Bailey, Governor, Bank of England; Professor Jonathan Haskel, External Member, Monetary Policy Committee; Dr Catherine Mann, External Member, Monetary Policy Committee; Sir Dave Ramsden, Deputy Governor for Markets and Banking, Bank of England.

Examination of witnesses

Witnesses: Andrew Bailey, Professor Jonathan Haskel, Dr Catherine Mann and Sir Dave Ramsden.

Q962 **Chair:** Welcome to this Treasury Committee evidence session on the Bank of England's monetary policy reports. I appreciate that we are meeting on the eve of a major fiscal event. I just want to put on record that nothing you say should be interpreted as any kind of signal about the contents of the autumn statement tomorrow, but we will still try and get it out of you. Can I please invite our witnesses today to introduce themselves, starting with yourself, Governor?

Andrew Bailey: I am Andrew Bailey, Governor of the Bank of England. For the record, I do not know what is in the autumn statement. You can try, but you will not get very far.

Sir Dave Ramsden: I am Dave Ramsden. I am the deputy governor for markets and banking at the Bank of England.

Dr Mann: I am Catherine Mann. I am an external member on the Monetary Policy Committee.



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Professor Haskel: I am Jonathan Haskel. I am an external member of the Monetary Policy Committee and a professor at Imperial College London.

Q963 **Chair:** Thank you so much. I am going to start with the inflation print. When we saw you this time last year, inflation would have been around 11%. It is now down to 4.7%. Your target for inflation is 2% plus or minus.

Would you agree with what the markets are currently saying, which is that you have done enough in terms of interest rates, that inflation will now naturally fall to its targets of 2% over the course of the next year, all other things being equal, and that mortgage payers around the country can breathe a sigh of relief that you are not going to hike rates again, Governor?

Andrew Bailey: I am sorry to be annoying, but it is 4.6%, not 4.7%, just for the record.

Chair: It is 4.6%, for the record, yes.

Andrew Bailey: It was good news last week. It was largely news that we expected. There was a small amount of extra news on services inflation, but it was largely news that we expected.

As we set out in the monetary policy report three weeks ago, we expect a little bit more of what I would call the unwinding of last year's external shocks to come through. We are not going to get another one like last week, though. That is the last of those base effects to come through, but we think there is a bit more to come through, certainly on food. That will come through probably by the end of the first quarter of next year or a little bit beyond that. After that, we are unwinding what we call the second-round effects, the degree to which these shocks have become more embedded in domestic price-setting and domestic inflation.

As you can see from the recent voting on the committee and the distribution of the votes of my colleagues here, we do take different views on this. I will set out the balance sheet of those views to start with. We have seen slight downside news on inflation this year. It is going to end the year a bit lower than we thought, but not by much. We have seen a weakening picture of demand in the economy. We have seen some weakening on the quantity side of the labour market; it is a little bit hard to read at the moment for reasons we may come on to. On the wages side, I can see some signs of it beginning to come off, but it is still well above where we thought it would be and well above a level consistent with the target.

Looking forward, you can take several views of that. The view I personally take is that we have now seen signs that we are on target. We are on target to come back to 2%. The current setting of policy is restrictive. We have used that word, as have other central banks, to



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describe the fact that it is, in a sense, causing a restriction within the economy that should bring inflation back to target.

Q964 **Chair:** We have reached Table Mountain in terms of interest rates.

Andrew Bailey: Yes. Table Mountain is quite a good analogy, in the sense that there is a case now, I personally think, for holding the rate where it is. We have been quite careful in the language we have used. We have used the term “for an extended period”.

The risks—the committee is all in one place on this—are all still on the upside. I would draw out a couple of those. One of those is the question about the domestic effects of inflation and particularly the performance of the supply side of the economy.

One of the changes we made in the November report was to raise our assessment of the medium-term equilibrium level of unemployment. That is because we do not think the labour market is performing as efficiently as it was. There is inefficiency in job matching. That is one of the reasons why wage pressure is higher than we thought we would see it. We do see upside from there.

The second one is really related to the tragic events in the Middle East. Interestingly, when it started, if you had asked me what would happen to the oil price, I would have said that it would go up and it has not. It is currently lower than it was when we did the report, but it is still a risk. We have to say it is still a risk. If there were a wider regional engagement in this issue, it would risk putting the oil price up.

Q965 **Chair:** I am hearing you say that, all other things being equal, with inflation currently at 4.6% and rates at 5.25%, we are at that top level in terms of Table Mountain. You will keep those rates for an extended period, but there are sufficient expectations in your forecast that, although it is double your target, inflation will return to target. That is what your forecasts are saying.

Andrew Bailey: I will give you my view. You should ask my colleagues because you will get different views on this, and that is perfectly reasonable. My view is that it is sensible, based on what we have seen to date, to keep rates where they are. That was our decision three weeks ago. However, I have to say—this is where I would stand out from the wider commentary there is around this—I think the risk still remains on the upside.

Q966 **Chair:** Let us hear from those who voted at the last meeting for another increase in rates. I know that mortgage payers across the country would be very interested in that.

Dr Mann: Thank you very much for the opportunity to join you here and talk about the monetary policy report, the decisions we have made and the way we make our decisions.



In my view, there is a soft patch right now—we see it in the data—but I look forward in making my decisions at the prospects for next year and beyond that. When I look at firm surveys about what their expectations are for their pricing capability next year, they continue to show that they believe they will be able to get price increases of 4.5% to 5%, and up to 6% in the services sector. That is from our decision-maker panel, which, as you know, is our firm-level survey.

Those same firms believe they will be offering wage increases of about 5% next year and they intend to increase their employment levels by about 1.2%. That does not sound like a lot, but it is faster than they had increased employment pre-Covid. They are looking forward, next year, to being more robust than they are right now.

From my perspective, what they think they are going to be able to do next year is very important in my decision about how I should react with monetary policy right now.

Q967 Chair: Would you be happier if rates were higher than they are now?

Dr Mann: Yes, for two reasons. First, as I say, looking forward I see continued price pressures coming through firms' expectations. They tend to be right. We can look at the past history.

Price pressures will continue to be at 5% or so throughout next year. In the macroeconomic forecast in the MPR, we also have the mean forecast. That includes the skew or the expectation, which collectively we have put into our forecast, that inflation will not get to 2% until mid-way through 2026.

From that standpoint, yes, I believe that more tightness now is important to cement our commitment to the 2% target.

Q968 Chair: We are publishing your summary of what your decisions have been in the last year and Professor Haskel's¹ today. I am also interested in what is currently priced into the market. It seems like the market is thinking that you are not going to hike collectively and that the next move you make is going to be a reduction in interest rates next August.

All of you, including the chief economist Huw Pill, have been out there making a range of statements. There has been some speculation on future interest rate cuts. Governor, you have said it is far too early to speculate about rate cuts.

One of the things we have heard evidence on, which I know is part of Ben Bernanke's review of your decision-making, has been around communication and clarity of communication. Governor, why is it not possible to simply say, "Our job is to make sure inflation returns to target and we will take those decisions", instead of entering into this

¹ Correction: The Report by Sir Dave Ramsden (Deputy Governor for Markets and Banking), not Professor Jonathan Haskel was published that day.



commentary and speculation about what is going on in the market?

Andrew Bailey: We say regularly that it is our job to hit the target. It is our job to hit the target sustainably. That is our job. We tend to be quite cautious about commenting on the market curve because, frankly, most of the time there is not a lot of difference between our own thinking and the market's. A year ago, as you may remember, we did quite explicitly comment because we felt there was a risk premium there.

Q969 **Chair:** It was much more recent than that. The chief economist said that market expectations for cuts were not unreasonable. The next day you came out and said it was still too early to be talking about rate cuts. Yesterday, you said it was far too early to be talking about rate cuts. It is like a running commentary to the markets.

Andrew Bailey: Catherine has set out the prognosis very well. If I am honest, the market is putting too much weight on the current data releases. The fact that we have seen inflation come down quite rapidly is good news. Catherine has set it out. We may differ at the margin, but we are basically in the same place in saying that we are concerned about the potential persistence of inflation as we go through the remainder of the journey down to 2%. The market is underestimating that.

Dr Mann: I just want to say that actions speak louder than words, especially when you deal with the markets. That is a key reason why I believe it is important to have action in showing commitment to the target.

Q970 **Chair:** What I am mystified by is the running commentary. Sir Dave, you have also commented recently.

Sir Dave Ramsden: I have commented. There is a challenge for monetary policy makers globally as well as in the UK because we are encouraged to communicate about our decisions and how they relate to the economy. We are encouraged to be accountable for them.

In my role as deputy governor for markets and banking, it is really important that I am in tune with market sentiment and understand that rationale for the views they have. They are entitled to those views, but—you are probably referring to this—in a speech on Friday I set out that the market curve had fallen by about 50 basis points, if you look at the average for the swap curve over the next three years, since the assumption we made in the monetary policy report.

That assumption in the monetary policy report was one of our conditioning assumptions, which, as Andrew says, frames our forecast view. If you have had a market fall of 50 basis points, other things being equal, you have less restrictive monetary conditions so you are supporting demand.

To Andrew's point—this is where we all agree—supply is constrained. The speed limit of the economy is low at the moment. It has been low for



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many years, but it is particularly low at the moment. Were that market curve to be borne out, it would mean more demand relative to our expectations, which increases the chances of inflation being above target.

As Catherine has already said, on our mean forecast, inflation only gets back to target in 2026. Back to your point, we are absolutely committed to getting inflation back to the 2% target. We can understand the markets, but we are setting Bank rate to get inflation back to target, and that is what we will do.

Professor Haskel: I have two quick points, if I may. First, you referred to Huw Pill. I think Huw was misquoted.

Q971 **Chair:** I have it verbatim in front of me: "It's really too early to be talking about cutting rates". That is what the Governor said after Huw Pill said that market expectations for cuts next year were not unreasonable.

Professor Haskel: If I may, I have the text as well. He said, "That's what financial markets currently anticipate, and it doesn't seem totally unreasonable". Then he went on to say "if nothing new has happened", et cetera. My view is that Huw was describing not what he thinks or what we think but what the market thinks, which is quite a different thing. That is one point.

If I may, I have a second point. As Andrew has rightly said, it is very welcome that the headline figure has come down from 6.7% to 4.6%, but what is complicated about this is that that is not a good guide to underlying inflation, as Catherine was saying. Rather, we look at other indicators—we have said this publicly—such as wage inflation or service sector inflation, and they are still quite high.

The picture is rather complicated. People look at the headline figure and go, "My goodness me, the job is done. Cuts are coming", and all this, that and the other. Perhaps some of them fail to appreciate that we are looking at a different set of measures.

Q972 **Chair:** The reason I am raising these points about communication is that, clearly, there are people who pay mortgages up and down the country; there are people making business decisions up and down the country. They hear this confusing running commentary, which makes it very hard for them to make decisions in the real world.

Sir Dave Ramsden: It is not a confusing running commentary. We are commenting and being very clear in distancing ourselves from market expectations. To Jonathan's point—again, I stressed this in my speech on Friday—by the end of Q1, we think headline inflation on our current projections will be at 3.8%. That is further good news, but we are forecasting that services inflation, which is 45% of the inflation basket, will still be at 6.4%.

As Jonathan and Andrew say, those are the indicators of persistence that we are focusing on in setting Bank rate at the current level it is at.



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Markets are entitled to their view, but we are not validating that view when we comment on it. That is Huw's position, Andrew's position or my position when we comment on markets. We do have to get out into the world to communicate.

For households and businesses, you can look in the surveys of inflation expectations at what has happened to medium-term expectations. Catherine has mentioned the DMP survey.

Chair: What does DMP stand for?

Sir Dave Ramsden: It is the decision-maker panel. I am sorry. There are too many acronyms.

Professor Haskel: It is a firm survey.

Sir Dave Ramsden: That is a firm survey. When you look at household surveys—households are the ones taking out mortgages—those medium-term expectations have come down a lot. I would say they are consistent with inflation expectations being anchored at the target, so I think there is certainty that we will do our job to get inflation back to target.

Q973 **Chair:** My understanding is that when Ben Bernanke publishes his review he is also looking at the way the Bank communicates.

Sir Dave Ramsden: He is looking at the way the Bank uses forecasts.

Chair: He is looking at the way the Bank uses forecasts to communicate.

Sir Dave Ramsden: Yes.

Q974 **Chair:** Can I turn now to quantitative tightening? Again, the Bank has made the decision to sell more bonds next year. When we have asked you before about whether this has any tightening impact in the real world, you have said that you do not know, but you think it is quite small. Since you have been continuing with that process, have you obtained any more information about how that is affecting real-world mortgage payers?

Andrew Bailey: Can I just start with one point? Last year, we sold £80 billion of gilts—either we sold them or they naturally redeemed themselves—and between £19 billion and £20 billion of corporate bonds. If you take the total, it is just under £100 billion. We do not have any more corporate bonds, so there are no more corporate bonds to sell. This year we will sell £100 billion of gilts.

Q975 **Chair:** Is it having a real-world impact? Is it causing mortgage rates, for example, to be higher than they would be otherwise? Is it tightening, in the real sense of tightening?

Andrew Bailey: Given the evidence we have now—we covered this quite a bit in the August monetary policy report—we have not really updated or changed our view on that. The impact on yields is not any larger. It is



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quite small. Our staff estimated that around 10 to 15 basis points would be coming through.

By the way, just to make an important point, which I know we have made before, we set monetary policy knowing what that is because that is coming through in the yield curve. We take the yield curve into consideration in setting policy and doing our forecasting. We know those numbers. They are factored in, as it were. Dave is the expert on this. We have no reason to change that view.

Q976 **Chair:** Mortgage rates are 10 to 15 basis points higher than they would be otherwise. Is that what I am hearing?

Andrew Bailey: No.

Sir Dave Ramsden: If I can come in, we have been selling across the maturity buckets, short term, medium term and long term. As we told you when we gave evidence on QT in May and as we repeated in the monetary policy report box in August, we have only just started doing QT. It is not that we do not know, but our assessments have to be based somewhat on our experience of doing QE and the conditions there. From doing QT so far in the first year, which was £100 billion, as Andrew says, we think the impact on long-term yields is about 10 to 15 basis points.

Chair: That is presumably being passed on through—

Sir Dave Ramsden: No, that is at the long end. Mortgages tend to be priced off the two-year curve or the five-year curve for a fixed-rate mortgage. There might be a very marginal effect, but, over that time, mortgage rates have gone up by hundreds of basis points.

When we set out on quantitative tightening, we said we thought the effect on market rates would be modest. All the evidence we have is that it is really modest. It is 10 or 15 basis points at a time when yields have gone up by hundreds of basis points. We see quantitative tightening as operating in the background. As Andrew said, we know what is happening with quantitative tightening when we set Bank rate because it is already priced into the yield curve.

Andrew Bailey: We take it into account fully.

Q977 **Chair:** That is fair enough. I am going to shift slightly and ask about mortgage payers again. You mentioned how much mortgage rates have gone up. Would you say that that increase in mortgage rates now is entirely down to monetary policy decisions or is there still any impact from fiscal policy?

Sir Dave Ramsden: When you look at an increase in the market curve, you have to disaggregate it into the different effects. By the time we got to the November MPR, a few weeks ago, we thought that by far the majority of the increase in the whole yield curve, right across the yield



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curve, was down to expected monetary policy. That is by far the key driver.

However, in addition to that, when you look at the very long end, 10 years and beyond out to 30-year yields—we did comment on this in the minutes—there may have been some effect coming through from an assessment of the change in issuance coming out of US markets. The treasury market is by far the biggest bond market in the world, and that was having spillovers to the UK at the time of the November MPR.

There may have also been—Andrew has referred to this—some increased uncertainty about what the future held. You might have got a risk premium there. The tragic events in the Middle East meant there may have been a bit more uncertainty at that time about inflation.

You are right. By far the dominant feature was expected monetary policy. A year ago was a very unusual period. UK fiscal policy was very unstable just over a year ago. That was having an effect, particularly at the long end of our curve.

Q978 **Chair:** It was having an effect. Is it having an effect today?

Sir Dave Ramsden: It is very difficult to discern a specific uncertainty premium from that now. From my time in the Treasury, before my time in the Bank of England, I know that markets like stability and certainty in policy-making. They have certainly had a lot more of that since September or October 2022.

Q979 **Chair:** Over the last year, would you say that fiscal policy-making has helped with your task of getting inflation back down?

Sir Dave Ramsden: It is difficult to discern that from the market curve. In terms of the economic assumptions we make, fiscal policy is becoming less supportive of demand over that period, as the energy price guarantee stops, for example. Energy prices have come down to below where the energy price guarantee is set. Fiscal policy is providing less support to the economy than it was, but that is because energy prices have come back into more sustainable territory.

Chair: I have been hogging far too much time. My colleagues will get cross with me.

Q980 **Anne Marie Morris:** Thank you, Chair. We would not dream of saying that. Can I drill down a little bit further into the inflation target? Your mandate, effectively, is to get it back down to 2%. The timeline for doing that has been moving. It was originally going to be 2025, Catherine, in the report. It is now going to be 2026.

Can you explain what your thinking is? How do you calculate or estimate the speed with which we are going to get back to 2%? What might or might not happen to drive that date even further away?



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Andrew Bailey: On the thing about 2025 and 2026, we produce what we call a modal view, which is the central view, and we produce a mean view, which takes the risk into account. Catherine was describing the mean view. There is nothing wrong with that. We spend a lot of time on it. The modal view is late 2025 and the mean view is 2026. By the way, you get pretty similar story if you look at the ECB or the Federal Reserve forecasts in terms of when they get to 2%. There is a lot of commonality around that.

In terms of what has driven it, we published the forecast three weeks ago. I would point to a couple of things in particular in terms of that second year of the forecast. First, as Catherine was saying, there is evidence of some greater persistence in inflation. Catherine pointed to this question of the labour market and how efficiently it is operating. We reduced our view of the supply capacity of the economy. That does tend to put some inflationary pressure into the system. That also offset a weakening in demand that we saw. Although we are seeing some weakening in activity in the economy, the weakening of the supply side offset that. In a sense, it contributed to holding inflation up.

Secondly, at the time we did the forecast, a month ago, we had seen some increase in energy prices following the terrible events in the Middle East. That had also put some upside into the inflation forecast in the second year. As things stand, that second thing has gone away since we did the forecast. That is in the nature of things. These things are all not very big and likely to be pretty uncertain at the moment. I would not put too much weight on this. If anything, those things were shading the second year up, but the first year has come down.

In terms of the judgment as to when inflation comes back to target, this is important because it is price stability. It shapes people's expectations, which means that price stability is sustained. On the other hand, the judgment we have to make is that, if we tried to bring inflation back to target much more quickly by raising interest rates a lot, it would also cause inflation to be unstable. It would most likely cause it to go well below target thereafter. We would find ourselves with the opposite challenge pretty soon afterwards. That is really not consistent with having inflation at target on a sustained basis.

In my view, we always have to make this judgment. There is a trade-off going on at the moment between inflation on the one side and weaker activity on the other side. We call that a trade-off. We have to manage that trade-off through. The profile we have at the moment does that in a way that is more likely to mean we have a more sustained profile of inflation going forwards over the medium term. That is what we need for price stability.

Sir Dave Ramsden: If I can come in, as Andrew says, there is a kind of commonality, between us, the Fed and the ECB, as to what we are all worried about. There is this phrase, "The last mile is the hardest". We



have inflation coming back to 3% by the end of next year, but then it takes another year to get to 2%. That comes back to this persistence issue that Andrew is emphasising.

Coming back to this discussion of what markets think and what the outside world thinks, we are more worried about persistence. At the back of the MPR, we publish the average of independent forecasters. They have inflation coming back to 2.4% by the end of next year. We challenge that—that is common across all of us—because we think wages are going to take longer to come down. Services is a very labour-intensive part of the economy. It is going to take longer for services to get down, given where the economy is.

That is a difference of judgment. Andrew has explained the underpinnings of that difference in judgment. We are a bit more pessimistic about the supply side. As Catherine has said, she is a bit more optimistic about the demand side. She thinks there is going to be more momentum.

That is what is giving us this worry about the last mile being the hardest in getting inflation from 3% down to 2%. That is why we said in the minutes of the November meeting that we thought policy was going to have to stay restrictive for an extended period in order to get inflation out of the system to the point where it gets back to the 2% target.

Q981 Anne Marie Morris: Thank you. That was helpful. Dr Mann, the 2% target is largely predicated on that being—it is a bit like Covid—the R number. Are we getting back to the right R^* ? The R^* rate has effectively been fixed at 2%. That number supposedly has employment and inflation in balance. Given what you now see, is 2% the right number to represent R^* ? Should we be looking instead at a different and probably higher number, such as 3%?

Clearly, your activity needs to reflect reality in terms of where you realistically can get to. I accept that your mandate is 2%, but I suppose I am asking you whether that target is still reflective of the true R^* number as we see it today. If it is not, getting back to 2% by 2026 or, indeed, 2027 could be more than just the last hard mile.

Dr Mann: You have brought up in your question two concepts. The first is our remit, which is for stable 2% inflation in the medium term. The second is the concept of R^* , which is the Bank rate that is consistent with the inflation remit and with unemployment being stable, with not too much tightness in the labour market. Those are two separate concepts. They are related. The key ingredient between the two of them is productivity growth, for example, but they are not the same. R^* is not 2%. That is that.

The 2% target is what you have told us to do. That is our remit. I am not going to question that. You can, if you want, give us something else to do. That is fine. The other question, though, was about the equilibrium interest rate or the Bank rate that achieves that objective as well as the



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objective of stable employment. There are two ingredients in that that also have to be considered.

One is how much volatility there is in the underlying inflation environment. That is where price stability says there is no volatility and therefore R^* is what it is, 2.25%. If the underlying environment is much more volatile, that would contribute to a higher R^* , in my view. My understanding of the relationship between the inflation environment and the underlying employment or labour market environment says that there is an inflation risk premium, which has to be incorporated into the Bank rate that would be appropriate to bring inflation to the 2% objective.

Andrew Bailey: I just want to add to one point that Catherine made. I agree entirely with Catherine that 2% is the target that has been set for us, but it is important to understand where that comes from. The objective is price stability. Price stability has to be turned into a number.

There is no magic answer to this question, but I always go with something that Alan Greenspan may or may not have said. It is now associated with him, and I will say that he did say it. Price stability is the state of being where people do not factor what they expect future inflation to be into their everyday decisions, whether they buy something today or leave it for the future or whether they invest now or do not invest now. That is important.

Why is it 2%? It is a number that is bigger than zero, because zero would not allow relative prices to change, but is not a number that is big enough that people do start to factor that in. I think 2% is a reasonable approximation of that definition.

Can I make one final point? Even if you think 2% is not the right number, now is a very bad time to change it. I hear people say this. They say, "This last mile is going to be the hardest. Therefore, we need to change the target". That is really a very bad argument, if you do not mind me saying so. That is saying, "We are going to find it quite difficult to get from 3% to 2%, so let us call it 3%". Frankly, the next time we have this problem people will say, "Let us call it 4%". That is a very bad place to be.

I am going to be quite rigid about this, if you do not mind. There is not an objective magic to 2%, but it is the operational definition of price stability. That is absolutely crucial.

Sir Dave Ramsden: In the UK, we ended up with a 2% symmetric target in 1997 on the CPI measure. Other countries and jurisdictions have converged on 2%. When the ECB was set up, "up to 2%" was its definition, but it has now moved over time to a symmetric target around 2%. The Fed has moved to more of an average, but they all use 2%. As Andrew says, there is no particular magic to 2%, but it is the broad consensus across advanced economies.



Q982 **Anne Marie Morris:** I want to ask one final question, if I may, Chair. I hear what you all say. It is not an exact science. Central banks across the world are adopting a similar approach. It has been picked as a working model rather than on the basis of any evidence that 2% is absolutely the right number. Come 2026, what will you do if it is clear we cannot get inflation down to 2%? I appreciate your mandate. Will you start doing some analysis? Will you say to Government, "This is not deliverable; it is not achievable", or will you just keep pushing the deadline?

Andrew Bailey: It is a very fair question. The big question we would have to answer then is, "Why is it not coming down to 2%?" The answer to that question would drive what the next step should be. It is not necessary that the next step would be to raise the target.

The answer to that question might be to simplify because we cannot get demand down for whatever reason or it might be—this is a real issue at the moment, as we have discussed in the report—that there is a structural weakness on the supply side of the economy, which is causing the pressure on inflation, because inflation is the balance of demand and supply and we have a very weak supply side.

To me, if that were the case, the answer would not be to raise the target. We would have to take a very hard look—with Government because a lot of this would go to other areas of policy—as to why we seem to be facing that situation on a long-run basis.

Chair: Let us hope, hypothetically.

Q983 **Danny Kruger:** I first want to ask a question about the labour market data you use and data in general, and then I am going to come back to QT, if that is okay. I am not sure who I am directing this at, so anybody who feels like it should jump in on this.

The ONS data from the labour force survey has a quite a poor response rate—I would be interested in your views on that—compared to other countries, which apparently do it better. It seems to have overestimated labour market participation. I would be interested in your reflections on that. Meanwhile, the purchasing managers' index may have underreported economic activity. Both of these are rather gloomy bits of news for the economy.

I would be interested to understand the extent to which you feel these apparently incorrect datasets have influenced your decision-making and what we can do to improve the quality of the data.

Andrew Bailey: My colleagues will want to come in. Jonathan is a real expert in this area. Generally, the moral of the story is not to over-rely on any one data series to set policy. That is what we do. We aim to build up a picture from as many data sources as we can get. In doing so, we do not over-rely on one.



You are right: the LFS's employment and participation series has had problems. As we understand them, those problems are down to the rate of participation in the survey. We can come back to that. We have, therefore, used other sources of information. Out of that, we have produced a composite measure. One of the observations I would make is that the LFS data were becoming too volatile in the short run to be plausible.

Before I hand over, let me just say one thing. That approach is better for estimating employment and unemployment; it is not so good for participation, where the LFS is much more the unique source. You are right about one measure of participation. As I understand it, the reason for that is that the ONS stopped ageing the population a year or two ago. As a consequence, that can introduce a bias into participation. As we all get older, we tend to participate less, so it could overstate participation. I am probably going to hand over to the expert at this point.

Professor Haskel: Thanks very much, Andrew. I am very embarrassed to be called the expert. I should declare an interest. I have just stepped down as a board member at the UK Statistics Authority. I just wanted to make that clear.

You are right, Danny. The ONS has a lot of difficulties in these response rates. Indeed, you will have seen from a box in the MPR that falling response rates are a symptom all over the world. In every country, response rates are falling.

Danny Kruger: America seems to be doing a lot better.

Professor Haskel: It has a much better level; that is true. To get over this, as you will know, a couple of Thursdays ago the ONS published its strategy for dealing with the kinds of difficulties Andrew has just been talking about, boosting response rates and all those kinds of things.

I will say two more things just quickly, if I may, not to repeat what Andrew was saying. First, I would emphasise that we do have other data sources. We have tax data, data on unemployment and employer surveys. We run our own survey, the decision-maker panel, as we have just mentioned, and so forth. That is one thing.

Secondly, you will have seen in the MPR that we set great store by the wage indicators and the indicators of wage inflation. As everybody in this room knows, those are not collected from the labour force survey; those are collected from a different survey. The response rate to that survey is over 80%. That looks like a much more secure survey upon which to base our judgments.

Q984 **Danny Kruger:** I am so sorry, Dr Mann. Because time is so tight, I am going to jump straight into my next question, if I may. It is one for the Governor. Going back to the question of QT and particularly the selling of bonds at a loss, can you just explain to me why, in this country, we are



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unwinding when that ultimately involves significant losses for the taxpayer? The ECB is not following that policy.

Andrew Bailey: Can I just be clear? Whether you unwind by selling or waiting for them to mature, one strategy does not avoid loss.

Q985 **Danny Kruger:** With the prices as they are at the moment, the losses are significant.

Andrew Bailey: In one strategy, the loss accrues via the carry cost of the bonds because of the difference in interest rates between the one you pay and the one you receive. In the other one, you crystallise it when you sell. I just want to make that point very clearly. There is not a distinction between central banks in the sense that one lot have discovered the magic answer as to how to make no loss and the other lot have not.

Q986 **Danny Kruger:** The losses are acute at the moment, given the prices we are looking at.

Andrew Bailey: Other central banks are accruing very large losses and liabilities on their balance sheets. Let us be very clear.

Q987 **Danny Kruger:** You are passing those to the taxpayer at the moment.

Sir Dave Ramsden: We have to put this in context, as we discussed with you back in May. We transferred gains of £123 billion cumulatively up to 2022. That was always anticipated, as set out in the original exchange of letters back in 2009. We are now accruing losses on that portfolio.

Q988 **Danny Kruger:** They might be of the same order.

Sir Dave Ramsden: We will see. It is hugely uncertain. It depends on the future path of Bank rate and yields.

Q989 **Danny Kruger:** Just to be clear, you do not have to be doing this. Other banks are not selling in the same way.

Sir Dave Ramsden: They are. Well, the US has a much shorter maturity on its portfolio. It bought a lot more short-term debt.

In the UK, we have traditionally, as a Government and as a set of public authorities, issued at the long end of the curve. We have many more long-dated debts. We bought many more long-dated gilts because we did not want to distort the market. We were buying in equal maturity buckets. We are selling, as I said in response to the Chair's question, across those maturity budgets. The losses we are currently incurring have to be set against that £123 billion gain.

Q990 **Danny Kruger:** Indeed, it would be a great shame if it were all wiped out. Let me ask you about the indemnity, the original exchange of letters by which the Treasury undertook to indemnify you against these losses. Is the Government's commitment inexhaustible? Might there be a point at which Government decide they are no longer prepared to carry these



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losses? What would you do in that situation?

Andrew Bailey: We regard the indemnity as binding, but your question is really one for Government, not for us.

Q991 **Danny Kruger:** What would you do if the Government were to say, "I am sorry, but we are no longer prepared to take these losses"?

Andrew Bailey: I am not going to go beyond saying there would be a discussion with Government.

Sir Dave Ramsden: Because we have the indemnity, it means that on our own balance sheet the amount of capital we need to support the risks we are taking in the APF can be relatively low. That is because we have been indemnified.

Crucially, in the context of this discussion—Andrew is quite right—the question of whether we are indemnified ultimately was a decision that the Treasury made. We asked for it; my and Andrew's predecessors asked for it. It is an incredibly important part of the governance because it means that we on the Monetary Policy Committee can make decisions about quantitative easing or quantitative tightening for monetary policy purposes without having to, as it were, internalise the cash flow gains or cash flow loss consequences.

Andrew Bailey: Can I just be very direct on this? Let us assume that the scenario you paint happens. I do not expect that it will, but let us assume for a moment that it does. The Government would then not have paid us in the context of an indemnity where we think the indemnity is good. Nobody has ever questioned it. Very literally, we would have to decide how to account for that. We would take the view that the Government have a liability to us, and we would have to decide how to book that on to our accounts.

Q992 **Danny Kruger:** You would not be able or prepared to go into negative equity like the Fed can.

Andrew Bailey: That is the point I am making. We would have to decide how to book that liability into the Bank's accounts.

Sir Dave Ramsden: The Fed can do that because it has different arrangements on seigniorage.

Q993 **Danny Kruger:** Thank you. That is very helpful. Let me move on to a related question. The other option is to make use of this new fiscal power you have acquired, which Parliament gave you through the Financial Services and Markets Act.

I would like to get your views on this. You are now in a position to apply this bank levy on the banks in order to fund your functions. I would quite like to understand, first, whether you set the levy unilaterally. Do you decide what you are going to charge the banks? Secondly, what is the scope? To what extent can you make use of this levy? Could it potentially



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be used to cover Bank losses that you are required to carry?

Andrew Bailey: To be very clear, we cannot conflate these two things. That is not the purpose of it. That is not how it is set out.

Q994 **Danny Kruger:** It is not the purpose, but does it have the capacity to do that?

Andrew Bailey: No. To paint the picture, you could not make the funding of the running costs of the Bank of England any more complicated if you tried, but that is history. There is 200 years of history. We are now talking about covering the costs of what we call our policy functions. This is monetary policy, financial stability and quite a bit of our markets area. Other things are paid for in other ways. That is by the bye.

Currently, they are paid for by what is called cash ratio deposits, where the banks place interest-free deposits with us and the yield on those deposits funds us.

Q995 **Danny Kruger:** You are now able to charge your own levy.

Andrew Bailey: Just to explain, the problem with that system is that it is exposed to interest rates. We earn the level of interest rates. It is not a great way to fund your budget.

Q996 **Danny Kruger:** This is much nicer. You can now charge the banks what you like.

Andrew Bailey: No, no, no. I am sorry. Let us be clear. We can come on to this. The process for setting the level of the cash ratio deposits, which has been there for years, involves consultation, including with the Treasury. We do not just make it up on our own.

In the new process, cash ratio deposits will go and instead it will be funded through a levy, which by the way is how the regulatory part of the Bank is funded and has been since it was created. There is nothing new there. Again, it will be subject to a consultation and subject to accountability. This Committee can bring us in on the subject, if you wish to. All is fine. It has the same checks and balances we have always had.

Sir Dave Ramsden: In fact, it has more. We have to reset the levy every year. Some commentary in the debate has suggested that our accountability to Parliament, as well as the Treasury, for resetting the levy means there will be more scrutiny of our budget than there was under the cash ratio deposit scheme, which was every five years.

Andrew Bailey: Yes, and it was very opaque.

Q997 **Danny Kruger:** Can I just get absolute clarity on this? This has been very helpful. Is it written in black and white that you are not allowed to use the levy to cover losses?

Andrew Bailey: We cannot use the levy to cover the losses on the APF.



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Q998 **Chair:** I just have one final question on these losses. When they get moved back to the Treasury, does the Treasury then have to find cuts in public spending to offset them that would have a fiscally tightening effect?

Sir Dave Ramsden: As Andrew said, we do not—

Q999 **Chair:** Can I have a yes or a no, Dave? We are short of time.

Sir Dave Ramsden: When the OBR, which, unlike last September, will be fully involved in this fiscal event, publishes its outlook, it will fully account for the cash flows.

Chair: Yes, it will.

Sir Dave Ramsden: There is no mechanistic read-across from what happens on the cash flows to the overall fiscal stance. That will be a decision for the Government.

Q1000 **Chair:** If they do not do anything about it, presumably it means there is an amount they have to find somewhere else.

Andrew Bailey: This is a question for the Treasury. This is about how public accounts work. We are not the experts.

Q1001 **Chair:** No, it is not. It is about how these things feed through into possible fiscal decisions by the Treasury that might tighten the fiscal and monetary stance of this country.

Andrew Bailey: That is my point. I am sorry, but that is a question about public accounts.

Q1002 **Chair:** Would you not take it into account in terms of your monetary policy decisions, if there were a significant fiscal impact?

Andrew Bailey: We take fiscal policy into account, clearly, yes.

Chair: No doubt this is to be continued.

Q1003 **Mr Baron:** I want to explore briefly the risks of overtightening. I have not been alone in this, but I have long suggested that the Bank was behind the curve in raising interest rates. I know the Bank has often quoted external shocks. Ukraine was probably one of the biggest, if not the biggest, and yet the month before the invasion of Ukraine inflation was running at over 6% and rising quickly, and interest rates were still at 0.5%.

I put it to you that you have had to play catch-up in very quick order. We have had a very quick succession of 18 interest rate rises in very short order.

Andrew Bailey: There have been 14.

Q1004 **Mr Baron:** I apologise. Even so, they have been the quickest in the Bank's history when it comes to interest rate rises in normal times at



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least. You have not had time to pause because interest rate rises very often have a time lag before they really affect the real economy. What would you say to that?

Andrew Bailey: One of the things we take into account—you are right: it is an important part of this consideration—is what we call the transmission of monetary policy decisions or, in other words, how the decisions that we take feed through. We know that happens over a period of time.

Our staff have done a very large amount of work to estimate, in their view, the best view they can come up with on the transmission of these 14 interest rate rises and where it stands today. That is an important part of our consideration of what we do next.

I will express this in terms of the level of GDP, the level of activity in the economy, because that is probably the most helpful way of doing it. What is the staff estimate? I am going to use a very important few words now: based on the average pattern of the past, not quite half of the effect has come through yet. We have not got to halfway, although we may not be far off halfway.

Q1005 **Mr Baron:** Can I just pick you up on that, if you do not mind? You are saying that around half of the effect has not been felt. Some would say that, because of the time lag in seeing the effect of interest rate rises or cuts in the economy, you are probably being optimistic on that, are you not? It normally takes six to 12 months to see the effect of interest rate rises on the economy. You just have not had the time to pause because you were playing catch-up.

Andrew Bailey: It is cumulative. We started raising interest rates two years ago.

Mr Baron: Yes, I know.

Andrew Bailey: I am talking about the whole thing now cumulatively. Some will have come through more than others. That is the point. The half is a representation of the sum of all that.

Q1006 **Mr Baron:** You did not have time to pause on your way up because you were so far behind the curve. Other central banks may have made their errors, but they started increasing earlier.

Andrew Bailey: I am sorry. We were the first major central bank to raise rates. That is not true.

Q1007 **Mr Baron:** Yes, but the point I am trying to suggest to you, Governor, is that you had to increase them so quickly because we in this country were so far behind the curve, so we have not had the time to pause to see the effect.



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Sir Dave Ramsden: We were not so far behind the curve. We raised interest rates in December 2021, which was before the Fed and before the European Central Bank. Those are the facts.

Q1008 **Mr Baron:** Look at where inflation was. If I may suggest, when inflation is at 6%, interest rates are at 0.5% and inflation is rising considerably, in most books that is behind the curve.

Sir Dave Ramsden: You are right: the headline inflation rate in January 2022 was 5.5%. That was the number we would have known at the time Russia invaded Ukraine. The inflation rate for electricity, gas and other fuels was 22.9%. That already reflected the build-up in gas prices from the increase in tensions around Ukraine. Fuel inflation was 23.6%. But services inflation, which as I mentioned earlier is 45% of the total, was only 3.2%. That is the measure of domestic inflationary pressures.

It is simply not the case that we were behind the curve when you look at the inflation numbers, when you look at the shocks we were dealing with and when you look at what other central banks did.

Q1009 **Mr Baron:** Let us, because I do want to move on, agree to disagree on that. I still believe that, given inflation was at 6% just before Ukraine, interest rates were still at 0.5% and inflation was rising steeply, you were behind the curve.

Let me put this to you. There is a concern in the markets that the Bank is looking backwards in trying to ascertain where inflation levels are going to be in the medium term. It is not looking at present indicators like retail sales, for example. Retail sales fell very sharply, as you know, in October. The September figures had to be revised down. The housing market is a current issue and very much in retreat.

Yet the Bank sometimes looks at wage growth, which is important but still has a historical element to it. To what extent would you answer the criticism that MPC policy is being guided through the rear-view mirror?

Andrew Bailey: I would not agree with that. You are right to say—this is embodied in the projections we produced in November—we have seen some weakening in demand. That is reflected in the projections. We have also seen a weakening on the supply side of the economy. We think the labour market story, I am afraid, does suggest the labour market is tighter now.

We do think there is what we call matching inefficiency. People looking for jobs are finding it harder; it is taking longer to find jobs and to be matched with jobs. That has caused us to weaken the supply side, to weaken the potential growth rate of the economy. Looking forwards—it is looking forwards—we think that is going to contribute to greater inflation persistence than we have previously thought.



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As you can see from this morning, we take slightly different views on this in terms of how significant it is and how much risk there is from it, but that is a forward-looking view; it is not a backward-looking view.

Professor Haskel: If I could add to that quickly, if you will forgive me, my earlier answer is evidence against this view that we are backward-looking. The headline number, as we said, has come down, but we are looking at the underlying numbers. Dave has mentioned services inflation, and I mentioned it earlier on core inflation. That is a much better guide to this forward-looking notion, and we said that in the MPR. I would be surprised if the markets had that view, actually.

Q1010 **Mr Baron:** I will move us on to the money supply figures. I know the Bank historically has not attached a lot of importance to them. I know there was one paragraph in the latest MPC report. That paragraph alone was more than they have been mentioned in the previous five reports. I know this is linked to quantitative easing and tightening, but there is strong evidence to suggest that money supply figures, the peaks and troughs, have influenced inflation figures, and yet the Bank has only devoted one paragraph to it.

We have seen a fall of 4.2% in broad money supply in September. That would suggest, in many books, considering that the pace seems to be picking up a little bit, we are heading into recession and we may indeed be over-tightening. What would you say to that criticism?

Andrew Bailey: We spend a lot of time looking at what I would call the evidence that underpins those numbers. That is not just a question of what is contributing to that monetary aggregate, but also, particularly for both the corporate sector and the household sector, what we deduce in terms of money and credit conditions at the moment.

It is interesting. At the moment for both sectors we are seeing some signs of small pick-ups in arrears, for instance, and some weakening in the demand for credit, but it is from a low level. We are not seeing what I would call a collapse in either the demand for credit or the ability of the financial system to supply credit.

Q1011 **Mr Baron:** You would accept, though, that quantitative tightening is to a certain extent a leap into the dark. That is going to restrict broad money supply, as you well know.

Andrew Bailey: Yes.

Q1012 **Mr Baron:** Does the Bank at least admit that we are in slightly unknown territory here?

Andrew Bailey: This is why, as we were saying earlier, we keep quantitative tightening under constant review. I have to say that so far I have not observed any effect that is giving me cause for alarm in terms of its impact on broader credit conditions and therefore the broader health of either the corporate sector or the household sector.



Sir Dave Ramsden: You are right to encourage us to keep looking and keep being able to understand these trends in money aggregates. You quoted the very large negative number of minus 4.2% in broad money growth. We know there is a base effect there. That goes back to last September and October when, because of what was happening in liability-driven investments, you had a very high level for broad money. It has come down sharply.

It is important that we can make sense of those trends alongside, as Andrew says, the underlying drivers that are driving those trends and driving our assessment of the economy.

Q1013 **Mr Baron:** I raise it because I want to express surprise that, given the strong evidence that peaks and troughs and money supply do influence inflation levels—and there is never black and white evidence when it comes to forecasting—the Bank only devotes one paragraph to this in a rather long quarterly report. The paragraph we have had recently is the longest it has been for five years. I find it very surprising that the Bank does not pay more attention to money supply.

Andrew Bailey: Again, I will repeat the point I made a few moments ago. If you look across all our publications, including our financial stability publications, which are important here, we devote a lot more attention to credit conditions.

Q1014 **Mr Baron:** This is not in the MPC report.

Andrew Bailey: It underpins the work. The MPC has access to all that work.

Sir Dave Ramsden: We are using it to underpin our analysis, but so are outside forecasters. Look at the consensus for GDP next year, the year after and the year after that. This is in chart A, right at the back on page 101 of the document. On average, outside forecasters are expecting GDP to be stronger than we are. This suggestion that somehow money indicators are pointing to a recession is not a view shared by outside forecasters.

Q1015 **Mr Baron:** Can I pick you up on that? It is a very valid point. Can you explain to me why the Bank of England forecasts tend to be a little bit more pessimistic? They have a record of being slightly more pessimistic about the growth of the UK economy. I know other forecasters do likewise. For example, of the last 28 IMF forecasts for the UK, 25 have undershot what turned out to be reality. The Bank of England seems to be joining them now and is more pessimistic compared to some other forecasts. Why is that?

Sir Dave Ramsden: My speech on Friday covered some of this. It certainly covered why we have been more pessimistic over the last year. If you look back to our November 2022 forecasts, you have to remember that all forecasts have to be based on conditioning assumptions and then our judgments. We were conditioning our forecasts at that point on



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energy prices that were much higher. It is a good thing that energy prices have come down. That is what has happened in global markets. Also, they came down supported by Government policy, as we were discussing.

Also, it is the case that we made a judgment of the impact that those energy prices would have on demand, and that turned out to be more pessimistic. Consumers and businesses were more resilient. That is why progressively since then, until our latest forecast, we have been revising up our demand judgments.

The other thing I would say, which is meaning that we are more pessimistic at the moment compared to, say, the average of outside forecasters—and this is a point that we have all highlighted today—is that we are more pessimistic about the supply potential of the economy. That is a judgment based on our assessment of the evidence of labour market participation that we have discussed, and our assessment of the medium-term equilibrium unemployment, but also, when you look at the business investment record of the UK, currently business investment in the UK is 6% higher than it was in 2016 Q2. That was the quarter of the referendum.

Q1016 Chair: Is that real or nominal?

Sir Dave Ramsden: That is real. It is 6% higher over a period of seven years. That is less than 1% a year. Over that time, US business investment has gone up by over 25%. As Jonathan's work shows, business investment is a key driver of capital deepening. That, in turn, is a key driver of the efficiency of the workforce, the capital that each member of the workforce has, and a key driver of potential growth. There is a whole host of factors for why supply might be weak, but we have taken on those factors maybe more than external forecasters have. We therefore think the speed limit the economy can grow at without triggering inflation is lower, but that is a judgment.

Mr Baron: Time will tell.

Chair: On the "time will tell" point, we suspect that you go on training programmes to give very long answers. That is just my observation, perhaps. I will not draw my colleagues into that.

Q1017 Dame Angela Eagle: Governor, there have been claims in some places that the Prime Minister personally is responsible for halving inflation. Do you agree with that?

Andrew Bailey: The Government and Prime Minister adopted a target. It is not our target. Let us be very clear on that. Any comment I make on that is always purely a matter of fact. I can tell you where the figures are, but it is not to do with our target.

Q1018 Dame Angela Eagle: Is it not your job to deal with inflation? Is that not why the Monetary Policy Committee exists? Have you not put interest



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rates up 14 times in the last two years to try to get inflation back to the 2% target?

Andrew Bailey: Yes, but let me also say this, as important background. Obviously, we have been hit by some very big external shocks. Those have important issues in other areas of public policy, whether that be defence, energy or food supply, so the fact that I talk to the Prime Minister, the Chancellor and other Ministers about these other issues is a good thing, frankly. I am always keen to know what is going on in other areas that affect us but, ultimately, it is our job to get inflation back to target.

Q1019 **Dame Angela Eagle:** We do not really have a system where the Prime Minister is responsible for inflation going up and, therefore, is responsible personally for inflation coming down either.

Andrew Bailey: No. It is very clear. The Bank of England is responsible for that.

Q1020 **Dame Angela Eagle:** Tax cuts have been signalled ahead of tomorrow's financial statement. Are you worried that, if tax cuts materialise tomorrow, they might be inflationary? Might you then raise interest rates higher, if there are tax cuts in the financial statement, to compensate?

Andrew Bailey: Let me say two things. I am going to repeat what I said at the beginning. I am going to wait and see what is announced tomorrow, because I do not know what is going to be announced tomorrow.

I will say one other thing, though, which is very germane to your point. The big difference between tomorrow and what happened just over a year ago is that the OBR is involved, so it is within the framework of the OBR, and that is very important.

Sir Dave Ramsden: This is always the case when we update our forecasts. When we updated them in November, the conditioning assumption was announced fiscal policy as of then. We will wait to see what is announced tomorrow, and then we will factor that into our next forecast.

Q1021 **Dame Angela Eagle:** I look forward to reading that, but briefly, again, on potential tax cuts, are there tax cuts that would not be inflationary? Presumably, they would be tax cuts where the money that was given to taxpayers would not be spent.

Andrew Bailey: I am really not going to speculate. I cannot speculate on what might be in tomorrow's announcement. I do not know what is going to be in tomorrow's announcement.

Q1022 **Dame Angela Eagle:** Would an inheritance tax cut, for example, just to take one issue, be less inflationary than a 1p cut in income tax?



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Andrew Bailey: We will see what comes out tomorrow. As Dave said, we will factor it in when it appears.

Q1023 **Dame Angela Eagle:** I want to ask you about food inflation, which peaked at 19.1% and is still at 10.1%, which is very high. Of course, that exacerbates the cost of living crisis, especially for those on low incomes. There is still a lag between the overall level of inflation, which is coming down, and food inflation. What do you think is going on?

Andrew Bailey: I made a speech on this subject last night.

Dame Angela Eagle: Yes, I have it.

Andrew Bailey: In the spirit of what the Chair said, I will not say a lot, but, if the speech is useful, that is good. I made a point last night that, going back to the beginning of this year, interestingly, some of the food retailers were telling us that food inflation would come down quite quickly this year. The farmers were giving us a much more cautious story. It was not just that I was speaking to the NFU last night and wanted to, in a sense, be in their good books. I said, "Look, the farmers were more right on this point than the retailers were".

One reason for that—and I have been on farms this year, talking to them directly—is that a particular consequence of Russia-Ukraine was the threat to disruption of inputs, fertiliser being a very good case in point that farmers mention to me regularly. Because farmers were very concerned about whether they would have access to these inputs, let alone the price, they bought further forward at higher prices, so they locked in higher costs. Obviously, that means that it takes longer for the inflation rate to come off. That is one story.

The second story is that there is a much larger share of energy costs in food production than I had imagined. I may be in the minority here. It has also taken the path of energy prices to come off to also start to bring food inflation down.

Q1024 **Dame Angela Eagle:** Food inflation lags, because of these changes in behaviour, are now much longer than was previously thought.

Andrew Bailey: As I say, this Russia-Ukraine thing is a particular situation.

Q1025 **Dame Angela Eagle:** There are the costs of haulage and of fertiliser, as you were just saying, on farms.

Sir Dave Ramsden: It was more the existential worry of whether they would be able to get hold of any energy. If you think back to last September, people were worried about whether there would be energy available through last winter, and what might be the next twist or turn in Russia-Ukraine. As Andrew says, because of that fear, they locked in on longer-term contracts. Then energy prices came down because the supply fears subsided, but they were locked in.



Q1026 Dame Angela Eagle: On services inflation, what are your views there, given that services form such a large percentage of our economy?

Sir Dave Ramsden: Services inflation is currently 6.6%. It is a bit lower than we had in the November MPR forecast. It is coming down, but we think it is going to be stuck above 6% until next spring. This comes back to the fact that services as a sector is very heterogeneous and varied, but typically it has a large labour input. It is not so capital intensive. We know that wages are running at more like 7% for the whole economy, but we think that, as wage inflation begins to come down and as slack opens up in the labour market, you will see wages come down; you will also see services come down.

I am not dismissing also the role of profits in services inflation. It is just that we do not have any very clear evidence on what is happening to profit margins in individual service sectors.

Q1027 Dame Angela Eagle: Bonuses might be a thing to look at. Have you looked at them?

Sir Dave Ramsden: We can certainly look at bonuses in wages in the financial sector, yes. That is very well measured. One of the reasons we tend to focus on labour market indicators and wage indicators is that we have the AWE survey, which gives us real-time estimates, whereas we do not have real-time estimates of margins. We are confident that, although there have been second-round effects with prices going up, wages going up and therefore that holding prices up, those second-round effects, as Andrew has been saying, are beginning to subside.

There are differences of view between us as to the extent this will happen, and that is one of the things that explains our different voting, but we do think that services inflation will subside through next year, and it needs to subside through next year because services inflation of above 6% is not consistent with getting headline inflation back to the 2% target.

Dr Mann: We look very carefully at the different kinds of services. The heterogeneity is a very important indicator. Many people think of services and only think about hospitality, for example, but in fact business services is a very important ingredient, financial services being in its own category. The wage dynamics and the strength of demand are very different when we think about business services, accounting, legal and so forth as compared to hospitality, which would be the restaurants, hotels, travel and so forth. We can look at how those are changing over time, but in both categories there is an awful lot of inertia. We have some interesting cutting-edge research that talks about inertia in pricing in the services sector.

Q1028 Dame Angela Eagle: Professor Haskel, you seem to want to say something. You are the statistician.



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Professor Haskel: I will not take very long. Wages are 60% of services, so, just to amplify what Dave was saying, the persistence in services inflation is very dependent upon what happens to wages.

Q1029 **Dame Angela Eagle:** Is this part of the reason why, Governor, you said that you still consider inflation risks to be on the upside, rather than this view that has been given recently that inflation has halved and is just going to carry on?

Andrew Bailey: There are two things. There is a Middle East risk in there, but I will put that to one side. There is a risk around this question about persistence in services. Catherine, I know you say quite regularly that, if you look back over the previous 20 years, what the relationship between goods prices and services prices was to keep inflation at target means that services inflation is going to have to come down quite a bit from where it is today to reestablish that.

I would only add to that—you may not agree with me on this—that the period where we had services inflation a bit above target but goods below was probably a period where world goods inflation was benefiting from China. We may or may not get that going forward, so we have to take all of that into consideration, but it suggests that we cannot have services inflation, as Dave has said, where it is today.

Professor Haskel: Pre financial crisis, as Andrew has just been saying, deflation from world good prices took 1% off what inflation would otherwise have been, so it gave that extra headroom for the higher services prices, which we probably will not have now.

Dr Mann: Goods has to go to from about 4.5% or 5% inflation now to minus 1% deflation, and services would have to go from over 6% down to 3%. That is if the configuration between goods and services were to return to where it was in the last 20 years. That is a long way for both to go.

Q1030 **Dame Angela Eagle:** With 60% of the costs in services being wages, in the services sector, which is mainly the private sector, where wage increases have been higher than they have in the public sector, you are implying stasis.

Professor Haskel: That depends upon what happens to productivity, because it is unit labour costs that matter, which is a function of both wages and productivity.

Q1031 **Dame Angela Eagle:** We have already heard how dire our performance on productivity has been.

Professor Haskel: In this Committee, we always end up coming back to productivity, I am afraid, so that is right, yes.

Sir Dave Ramsden: Without prolonging things too much, table 1.D of the monetary policy report gives our forecast for whole economy average



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weekly earnings. This year, it is 6.75% to the fourth quarter; next year it is 4.75%, the year after 2.75%, and then in 2026 2%. It is not stasis, but that would be getting wages for the whole economy, so that includes public sector, back to target-consistent rates. Remember that by 2026, on our modal forecast, which is the most likely forecast but not our average mean forecast, inflation is below target. It is 1.5% by 2026, so, in a sense, we have moved inflation from being above target to below target.

Q1032 Dame Angela Eagle: It sounds like the real key is major breakthroughs on productivity.

Sir Dave Ramsden: It always is.

Dame Angela Eagle: It is a bit like *Waiting for Godot*, I have to say.

Sir Dave Ramsden: Productivity is the key driver of living standards.

Andrew Bailey: Of course, *Godot* never arrived.

Dame Angela Eagle: I know. I was well aware when I used that analogy.

Q1033 Siobhain McDonagh: I want to look at housing. If we look at mortgage repossessions, with interest rates at a 15-year high and ever more people looking to renew their fixed terms, there seems to be an average increase of about £3,000 a year when refixing, or £60 a week, and most people do not have that in their budgets to meet, so there is an awful lot of fear about that out there.

There are 87,930 homeowners in mortgage arrears, and there were 4,185 repossession claims. As higher rates continue to have an impact, do you think we are going to see more and more people evicted from their homes?

Andrew Bailey: There are two things I would say on that. The first thing is on arrears. You are right. We obviously keep a very close eye on this for our role as regulator of the banking system. We are beginning to see some tick-up in arrears, but from pretty low levels. Why is that? One reason that the level is lower than we would expect it to be at the moment is what we were just talking about, which is that the strength of household earnings growth through wages has been higher, and that has supported people's capacity to pay the mortgage. We have seen less of this so far than we would have expected to see, and certainly what past evidence would expect. We have to watch it carefully. We are beginning to see, as I say, some tick-up, but it is still quite small relative to history.

The second thing is a very important structural change. For good reasons, it has now become much more difficult to repossess a house than it used to be. If I think back to the early 1990s recession, the rates of repossession that were going on then are completely different to what we are seeing today, and that is a good thing. Obviously, it will then come down to the lenders and the borrowers sorting out how to work this



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out going forwards, but the fact that we start with a system where, in a sense, the default is not to repossess the house quickly is a helpful thing in that respect.

Sir Dave Ramsden: If I could just emphasise one element that brings it back also to the economic situation, Andrew is absolutely right to highlight the role of wage growth, which we have to keep a very close eye on in terms of wanting to get inflation back to target. Wage growth has supported people's incomes, but what also has is that people now know in advance, if they are on a fixed-term mortgage, that it is going to come up for renewal. Their lender will get in touch with them. It is not in the lenders' interests to see properties repossessed. It creates challenges for them on their balance sheets, so they will get in touch. Borrowers know the range of products when they have to remortgage.

Q1034 Siobhain McDonagh: We are talking about a cohort of people who got their fixed terms at historically low levels, and in comparison to the 1990s we are talking about mortgages that are much bigger.

Sir Dave Ramsden: You are quite right, and we have discussed these cohort effects before, but the point I was going to add was that another key economic difference with the 1990s is what has happened to unemployment. If you like, the key trigger for householders not being able to service their mortgages through changes in their real incomes, if they are in work, is if they are made unemployed. Redundancies are picking up. Unemployment is picking up slightly, but it remains on the ONS's current experimental series at about 4.3%, so there is much less pressure coming through from the labour market to push households beyond arrears into repossessions.

That is not to downplay the seriousness of the situation. We are acutely aware that, as we put up mortgage rates, it is adding to the burden of mortgages, but we need to do that to reduce demand in the economy. With unemployment, it is still rising, and that is uncomfortable, but it is rising to 5%, so you have to look at that very material difference from the early 1990s.

Andrew Bailey: Can I make one other point? One of the other effects that has gone on is that the affordability tests on mortgages and the FPC's loan-to-income ratio limit has had the effect of restricting the number of households that have very high debt service ratio costs. There are still those there, but they have been limited.

However, I would hold my hand up at this point and say it means that we have to look more at the renting sector than we did before, because the proportion of home ownership has gone down, but those policies have limited high debt service ratio mortgage costs.

Q1035 Siobhain McDonagh: Many of those people who are excluded now from having a mortgage find themselves in the private rented sector with landlords who are buy-to-let landlords. We are seeing an increase in the



number of buy-to-let mortgages that are in arrears. I understand that in the last quarter they have gone up by 29%, and that is to 11,540. As a constituency MP, I am seeing more and more people coming in to see me with section 21 eviction notices because their landlords either want to get out of the sector or, from a London perspective, can always get more rent from somebody else. What happened to the future buy-to-let market?

Andrew Bailey: It is changing. It is probably declining a bit at the moment. It is also changing. The number of smaller buy-to-let owners, so those with a smaller number of properties, is declining, and it is becoming more of a commercial market. There seems to be a greater concentration, in the sense that, if you are in the buy-to-let market, you have more of them. You are a bigger player.

Q1036 **Siobhain McDonagh:** The smaller ones will leave the market.

Andrew Bailey: Yes, that is what we have observed.

Sir Dave Ramsden: You are absolutely right that we have been very focused—and it was something that Dame Angela mentioned—on the cost-of-living challenges that came through earlier on in this period through higher energy costs and food prices, which disproportionately impact low-income households, because that is a higher part of what they consume. You can also add the cost of renting to that. We talked about it quite a lot in the last financial stability report, and it is something we are very conscious of, because the rental part of the CPI is increasing materially. That is rental within services.

Professor Haskel: Rents are going up at around 6% at the moment, Dave, just as you say.

Sir Dave Ramsden: That is an aggregate. They could be going up more in certain sectors or constituencies, so we are very conscious of, if you like, that new part of the transmission mechanism. We were talking about the 1990s earlier. Now you have many more buy-to-let landlords who have taken out mortgages, and so they are passing on mortgage rate increases through to higher rents.

Dr Mann: There is another issue here, which is important to consider, that differentiates what we do with the Bank rate and the outcome in terms of the mortgage market. If we just look at the last year, mortgage rates have had a swing of 200 basis points from 4.75% at the low earlier this year to 6.5% or so for a two-year 75% LTV. That is a 200-basis-point swing in what you could get in the market for a mortgage.

That type of volatility is extremely challenging for a buy-to-let or even for an individual homeowner. We did not do that. We proceeded with our Bank rate increases through this, but the financial market transmission mechanism through mortgages ended up being exhibited in these very dramatic swings, peaks and troughs in the mortgage availability and price for those who are in the market.



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Sir Dave Ramsden: It comes back to a discussion we were having before you were able to join us. The peak that Catherine is talking about was last September or October, during the turmoil in financial markets.

Siobhain McDonagh: That was Liz Truss's financial moment or whatever she was calling it.

Sir Dave Ramsden: As Catherine was saying, they then came down a lot; then they went back up in the early summer when markets were very worried about persistence in inflation. We put a chart on this in the monetary policy report. In the last few months, mortgage rates have been coming back down again. A two-year fixed now would be back down below 5%. You need to shop around. There is that volatility that borrowers also have to take account of.

Q1037 **Siobhain McDonagh:** I hear what you say, Professor Haskel, about a 6% rent increase, but that is not what I see every week. I see rent increases of 20% or 25% that people who cannot meet what their rents are at the moment are facing. It is because we have poorer people now in the private rented sector who previously would have been in social housing. With a lack of regulation about how much rents can increase, that is having an ongoing effect.

Private renters are five times more likely to run out of food, to be unable to pay their gas and electricity bills, or to be unable to save any money, a bit like Dame Angela was saying about the cost of living. These private renters are having more heaped on them with less ability to make the demands. I know that you have taken on board private renting for the first time in the last meeting you had of the Monetary Policy Committee, but will it be an ongoing factor?

Professor Haskel: You raise a lot of really interesting points, all of which are very salient to us. I am sorry to be a boring statistician for a moment, but the 6% that I mentioned is the rents component of the CPI basket, and that is part of our 2% target, as we were just discussing earlier on. That, of course, represents all rents, both new rents being signed and the stock of rents that are currently in the market. That is the right way to measure the basket. If we were doing mobile phone prices, we would not want to measure just new mobile phone contracts. We would want to measure the whole basket of mobile phone contracts.

To your point, when your constituents come to you, I would guess that they are probably people signing new rental agreements. The ONS has an average of 14 months as the mean period over which a rental agreement lasts. I would guess that those people who are coming to you are signing new rental agreements, and those are much higher than the 6%. You see that in the Zoopla indicators and the other indicators that the commercial real estate agents are putting out. Those will feed through, I am sorry to say, to higher rents as well.



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You make a very good point that the 6% seems very unrealistic, I am sure, to many constituency MPs, but that is because, as I say, that is the whole basket and they are seeing a different type of it. All of this is very firmly on our radar.

Sir Dave Ramsden: We need to stress that the reason why we are so focused on getting inflation back to the 2% target is that high and volatile inflation hits the poorest households the hardest. Lots of the other things that you have been referring to are really in the remit of Government, but getting inflation back to low and stable rates is the best contribution that we can make.

Q1038 **Drew Hendry:** I will return to the theme in a minute, but I want to go back to you, Dr Mann, and something you said earlier this month in terms of climate change. You said, "If governments fail to rise to the challenge to put into place sufficient climate policies to achieve net zero sufficiently swiftly, then transition impacts may not be the main concern for monetary policy makers". Are UK net zero policies driving up inflation and, if so, to what degree?

Dr Mann: Let me start by saying that, even in countries that have no carbon policies at all, people are facing inflationary surges, particularly in food, associated with droughts, or in health, associated with pollution. Whether you have a target policy or not, the emissions associated with carbon are affecting the climate and, therefore, inflation.

The real question then is this. If you price in those externalities explicitly, then you are sending an appropriate signal to business and to households to change production strategy or behaviour. Those clearer signals move us in the direction of having a more resilient environment as well as a less carbon-intensive environment. The strategy of embodying those externalities in a commitment to either emissions trading certificates or a carbon tax sends the right signals.

How do we get involved from the standpoint of making monetary policy? Picking up what Dave just said, the clearer the signals to incorporate carbon into the prices, the better the response is of business and households. We produce clearer signals when we have low and stable inflation.

Q1039 **Drew Hendry:** When Government switch those signals, that obviously does not help.

Dr Mann: Policy uncertainty does not contribute effectively to clear signals.

Q1040 **Drew Hendry:** How far does our greater reliance on renewables in the UK reduce the impact here of a global increase in oil or gas prices?

Dr Mann: Having an energy mix is a foundation of having a more stable energy price to both businesses and consumers. Having the diversification of the energy mix is an important contributor. We are very



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dependent on gas and will continue to be for some time, but having more diversification is a recipe for getting more stable prices. Again, my view is that volatility in prices and mortgage rates contributes to an environment where it is very difficult to make the right decisions if you are in business or if you are a household.

Professor Haskel: Could I come in quickly just to amplify a little bit what Catherine was saying? This is something we have taken up on the monetary policy report. The difficulty with energy prices is that it all depends. If you have lots of renewables, the trouble is that the demand for energy goes up when it is cold, the sun is not shining and the wind is not blowing on wintery days. It is the interaction of how many renewables you have and the baseload.

If we do not have much baseload then, if you forgive the jargon, the marginal supplier is going to have to be from renewables. As I say, when the sun is not shining and the wind is not blowing, that is rather expensive because we are short of energy. In the UK, we are more exposed to the gas prices that Catherine just mentioned than in other countries, because of our lack of baseload.

Q1041 **Drew Hendry:** It is the lack of investment in storage.

Dr Mann: Transmission.

Q1042 **Drew Hendry:** Decades of underinvestment in transmission and things like that are key factors in where we are now.

Professor Haskel: It is back to the investment issue that Dave was mentioning earlier on.

Andrew Bailey: I visited Orkney in north-east Scotland recently to look at these things, and it was fascinating. There is no shortage of renewable energy, but, as we were just saying, you have to have the infrastructure to generate it and send it on to the mainland.

Q1043 **Drew Hendry:** That has been sadly lacking. Sticking with Dr Mann for the moment, let me move on to talk about the carbon price in the UK. It is now significantly below that of the EU. It is somewhere near half the price. What impact does the carbon price have on inflationary pressures?

Dr Mann: The important question to me about the divergence between the European Union emissions trading certificates and the price that they are in the UK is twofold. With the low price in the UK, it is not sending the right signals to move in the direction of having a more energy-secure environment and having that change in behaviour for consumers.

The second concern that I have about this divergence between the two emissions trading certificate costs relates to the incoming carbon border adjustment mechanism that is being deployed in the European Union in order to equalise the incoming carbon-intensive products so that European producers are not disadvantaged by having a higher carbon



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price. It may look like it is advantageous in the UK to have a low ETS, but in fact, for an exporter, there will be a tax in the end and that tax will accrue to the European Union.

Q1044 Drew Hendry: Thank you. I think that will be something that comes up in discussions a lot more in the future.

If I can turn to the Governor just now, it was interesting to hear your replies to my colleague earlier. I want to ask you a simple question, and hopefully you can give me a simple answer back. How concerned are you that the autumn statement could be inflationary?

Andrew Bailey: I am going to wait and see what is in it.

Q1045 Drew Hendry: How concerned are you? Yes, you can wait to see what is in something, but surely you would have your own issues.

Andrew Bailey: I will repeat a point I made to Dame Angela earlier. It is important that the OBR is fully engaged in this process, which obviously is a distinction from last year, because, while the OBR does not have a responsibility towards inflation directly, it has a responsibility towards the fiscal framework.

Q1046 Drew Hendry: So you are not concerned.

Andrew Bailey: As I say, I am waiting to see what is in it, but I take comfort from the fact that we are now running a process that the OBR is fully involved in.

Sir Dave Ramsden: We have a convention. Just to repeat a point I made to Dame Angela, the division of responsibilities is important. We take fiscal policy as given based on what is announced. In the November MPR, we had to go back to the March fiscal announcement. When we get through to our December round, which will start in a couple of weeks, we will be able to take an initial account of what comes out on Wednesday in the autumn statement and then we can fully incorporate it next February, but it is very important that we do our job based on our forecasts and the OBR supports the Government by producing its fiscal forecasts for the Government, so you have an independent body producing forecasts to frame Government decisions. We then take on those Government decisions.

Q1047 Drew Hendry: I want to come back to the forecasts if the Chair allows me to, but I just want to ask you, again, a very simple question. Over this autumn statement, how much communication have you had with the Treasury so far?

Andrew Bailey: The Treasury does not tell us what is in the statement ahead of time, particularly in this current context because we are not in a MPC meeting round at the moment. This was the case, of course, last autumn. If we were, then we would have a more intense level of communication, but we are not.



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I talk to the Chancellor. The Chancellor and I talk, but, again, I would put that entirely into the context of the framework that the OBR has, because this framework has fiscal rules. It has the OBR producing forecasts. It has the OBR effectively costing fiscal measures that the Government wish to put into effect. Putting those two together, the OBR will produce an assessment of whether what is announced fits within the framework of the rules, and that is very important.

Sir Dave Ramsden: The timing really does matter. I was the Treasury's chief economic adviser, so the Treasury's representative on the MPC, for 10 years, obviously not in any kind of voting capacity, but, if there was something to say about fiscal policy because we were right up against a fiscal event, I would try to, with the Chancellor's position, tell the MPC what was going to happen. If you think about it, sometimes we would have a fiscal event that was the day before the MPC, and so the MPC does not have enough time to take it into account, but also the Treasury knows at that point what is going to be in it. For this November's round, we made our announcements on 2 November, nearly three weeks ago, whereas the Treasury is making its announcements tomorrow, so there has been a long gap. That is why I said we will be able to take account of these things in December.

Q1048 **Drew Hendry:** It sounds suboptimal. Talking about that issue of the Bank assuming fiscal policy based on what has been previously announced, is that the optimal way for the Bank to model fiscal policy given that sometimes, as you have just pointed out, some of the measures are pre-announced?

Sir Dave Ramsden: No, because they are never officially pre-announced.

Andrew Bailey: I think the Speaker would have something to say about that.

Drew Hendry: He does, frequently.

Sir Dave Ramsden: We have been talking about things that create uncertainty and volatility. There has obviously been lots of speculation about what will be in the autumn statement, but it is absolutely right and a really important principle that we base our policy decisions and forecasts on formally announced policy.

I can give you an example of where there was a pre-announcement, which was last November. When the Prime Minister and Chancellor came in after September, we were told the basis of what would be in the energy price guarantee. It had not been formalised, but we were given a good indication in early November, well before their announcement. We were very clear and transparent that we had done the best endeavours to take account of that in our November decision, and then subsequently it was confirmed and we had got relatively close, because we had been told roughly what the energy price guarantee is.



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There can be flexibility, but it is very important that it should be transparent and communicated by the Treasury, because, if we know something that the rest of the world does not know, we are effectively announcing fiscal policy.

Drew Hendry: Dr Mann and Professor Haskel, what are your thoughts on that?

Professor Haskel: The convention of basing it on announced fiscal policy is absolutely right because, as you have just heard from Dave, otherwise we would be announcing what the Government's policy is, and that is not what we want to do.

Dr Mann: I agree with that, in the sense that otherwise we are not just announcing what fiscal policy might be, but we are making a judgment about what is being leaked to the press, what is going to stick to the wall and what is not. What is going to stick to the wall should not be our judgment.

Q1049 **Keir Mather:** I wanted to turn back to the question of business investment, which I know you spoke to earlier. I appreciate the point you made about the increase of 6% in business investment, but that is before we are forecast to have a fall of 1% in 2024, for it to be flat in 2025 and then raised by a comparatively modest 2% in 2026. When I speak to firms in my constituency, they want to be ambitious. They want to hire more people, invest more in skills and break into new markets, but there is that hesitancy and that hedging.

In light of this, I was wondering what your assessment is of the extent to which higher interest rates are holding back business investment over the medium term.

Sir Dave Ramsden: You can see a break in the trend for UK business investment in 2016. It had been going up since the global financial crisis, and then it flattened off from 2016 onwards. This is something we drew attention to when we did our last supply stocktake in the February 2023 MPR. Obviously, there would be a variety of explanations for why it flattened off. We have only seen 6% growth in business investment over seven years.

We know from a large body of analytical evidence that a key driver of business investment decisions is certainty. This comes back to something Catherine was saying. That is certainty about the outlook for the economy and stability, ideally through low and stable inflation, but also certainty about where fiscal policy is going. You also want certainty about the kinds of relationships your economy is going to have. It is hard to conclude otherwise than that the decision to leave the EU, while there may have been lots of good reasons for it, has chilled business investment. That is the context.

What we are having to do in terms of monetary policy is to make it restrictive, reducing the level of demand in the economy. We have talked



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a lot today about the impact that has had on households, through making the cost of mortgages more expensive, and renters, but putting up interest rates increases the cost of capital, and so it does put on hold business investment projects that would otherwise go ahead.

However, again, it comes back to this point that the best thing we can do to support a business investment-friendly environment is to get inflation back to target. There is short-term pain and a short-term impact on business investment through higher interest rates, but the long-term gain of that in terms of stability and uncertainty is the best foundation we can provide. Then these other issues that we have been touching on that will drive longer-term productivity are the key foundation to longer-term growth in business investment.

Q1050 **Keir Mather:** Do you have a view on whether those higher interest rates are stalling business investment for SMEs in particular, or is it more general?

Sir Dave Ramsden: It comes back again to some language that Catherine used earlier. You have to remember that businesses are very heterogenous and varied. Small businesses, in particular, are very varied in their approach or their structure. One common factor is that the vast majority of business investment is done by large companies. That is true in the UK. It is true in most OECD countries. When Catherine was chief economist at the OECD, this was always a focus of OECD work on business investment.

It might be a bit less true in, say, Germany, where there is a very large Mittelstand and a lot of medium-sized companies, but small businesses do very little of the total volume of business investment. Obviously, you want small businesses to grow, get bigger, become larger and then do more business, but SMEs do not. I cannot remember what the percentage is. Catherine or Jonathan might know.

Professor Haskell: It is a bit under 30%, so it is not nothing.

Dr Mann: I would make just two comments. One is that our agent surveys of business investment is an important fact-finding that we do on this. More than 50% of the businesses surveyed by the agents have said that Bank rate is not a factor when thinking about investment. There are other reasons having to do with the overall environment and prospects for their product.

The second point that I would make is that Bank rate as a driver of the weighted average cost of capital, which is the factor that businesses use to decide whether they are going to invest, is extremely small. There are all the other factors that are relevant: overall debt, credit availability, credit spreads, equity valuations and that sort of thing. We might wish that we had more of an effect, but in fact it is not that large.



Professor Haskel: I was going to say something very similar, if I may, which is just to amplify again what Dave was saying. Especially for small businesses, it is the condition of their balance sheet that is incredibly important. That is what the bank is going to look at, and the condition of the balance sheet is disproportionately, for small businesses, affected by overall activity. The more quickly we can get inflation down and get activity back to an even keel, the more quickly the small businesses you talked to in your constituency can get back to investing.

Andrew Bailey: The only point I would add, which comes through, again, from our agents' reports, is that they report that they see more SMEs who are paying down debt earlier in the current environment than would probably be the case in a lower interest rate environment. It is not surprising.

Q1051 **Keir Mather:** I take your point, Dr Mann, about the salience of interest rates as an issue for SMEs. I note from the report that it is growing as an issue of salience, even if it is not the top concern for SMEs.

Just to drill into the issue of SME policy further, it seems like there is this unique cocktail of challenges that they face, whether it is those supply-side shocks, the tailwind of impacts from the pandemic, and then that higher interest rate factor as well. In that context, I wonder what you think the long-term impact of those multifaceted challenges for SMEs will be over the next few years.

Andrew Bailey: I would come back to a point Dave made a few minutes ago. The difficulty with reaching overall conclusions is that it is a very heterogeneous sector. It is quite hard to generalise about small businesses in that sense, because they are in very different sectors of the economy. They have very different histories. I find it quite hard to generalise, frankly, about this. We come across very different stories when we go around the country.

Q1052 **Keir Mather:** Are there any sectoral specific implications that you can see in terms of these pressures for SMEs operating in particular sectors, or does the Bank take a more generalist approach?

Andrew Bailey: We do not have a particular sectoral story that we hear. As I said, we obviously have a whole other side of the activity of the Bank of England, but, in terms of the attitudes of the banks towards lending to SMEs, we do a credit condition survey. We get information through our supervisors regularly. Again, the overall judgment is that, given what has happened, this could be much worse. They are seeing some signs of pick-up in arrears, and some signs therefore of some problems emerging.

The banks, for their part, are therefore quite cautious about lending at the moment, but there is not a block on lending and, by the way, there is not a problem with lending from the point of view of the health of the banking system. That is a very important point in the current context. The constraint is not on the health of the banking system. The banks



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obviously are going to have to reach their own risk management judgments.

Sir Dave Ramsden: If you think back to the global financial crisis when there was clearly a credit crunch, banks were not sufficiently capitalised, so there was an unwarranted tightening in lending conditions. That is the phraseology we use. They are well capitalised now. They have been resilient throughout an extraordinary period, and so their tightening in credit standards reflects the wider deterioration in the economic outlook. They are doing what you would expect them to do, given their risk management, but there is not any kind of credit crunch where they are going over and above that.

The more quickly and sustainably we can get inflation back to target, the more you get stability in economic conditions and demands starting to pick up. That will create more investment opportunities, and the banks will therefore be looking for opportunities because they will want to loan money. That is the way we will see things working.

It is a challenging period at the moment for SMEs, but, in terms of their access to credit, it is nothing like it was after the global financial crisis, because the banks are in much better health, and that is a very important message that comes through from our financial stability report. On the financial stability side of the bank, we are acutely conscious of the need to look out for those credit crunch type conditions, and we are not seeing those.

Professor Haskel: Can I just say two things really quickly? One is that, indeed, the heterogeneity is very striking, but I hope we have not given the impression that we do not know what is going on, because our agents report to us very regularly and, of course, as Andrew has just been saying, we go around agency visits and we visit small firms. That is one thing.

The second thing is regarding the point about small businesses. What has always struck me, when one goes around and visits them, is that they have a hell of a lot on their plate. The situation we want to get to is the definition of monetary policy and low inflation, which, as Andrew was saying earlier on, is that we do not want them to have to notice us. The more quickly we can get back to that stable situation, the sooner they can get on with the things that they want to do.

Q1053 **Chair:** On this point about the labour market statistics, was there anything else you wanted to say on labour markets generally or on how you are seeing the pressures in terms of wages?

Dr Mann: I would like to make one point. We look at unemployment very carefully.

Q1054 **Chair:** It is a lagging indicator, is it not?



Dr Mann: It is still a very important indicator, but it is central to people who are inactive. They come into unemployment and then they transition to employment in an environment where there is still hiring, and that is why I look at forward-looking hiring indications or expectations for firms. That type of transition is a very different transition than from employment into unemployment, so that individual unemployment number has two bookends that are incredibly important to understand.

The survey that is currently being improved is going to give us more insight into those transitions because, when redundancies increase, that is one avenue into unemployment, but when inactivity decreases because people move into unemployment that is very positive. Understanding those transitions is a critical ingredient to thinking about prospects going forward in the labour market.

Professor Haskel: On this lagging indicator stuff, you are right that some of these indicators are lagging indicators. It is part of the reason why we have put a lot of effort into looking at vacancies, because vacancies are much more of a forward-looking indicator. After all, if I am posting a vacancy now, I have some prospect of gainful production in the future.

You will see in chart 2.12 in the MPR that we do a lot on the VU ratio. We have looked at the accuracy of the vacancy numbers again. They are collected by a different survey with much better response rates. I would just come back and say that there is a blend of some very forward-looking indicators as well.

Sir Dave Ramsden: We are looking more at things like the VU ratio, putting that as our measure of labour market tightness.

Q1055 **Chair:** What ratio is that?

Sir Dave Ramsden: It is vacancies to unemployment. We are putting that into our models of wages, for example. I would make a more general point, Chair, about the issues with the labour force survey. Although we have all these other indicators, they have added additional uncertainty. I support what the ONS is doing through its action plan to increase response rates, so we can move off the experimental labour force survey numbers that it is giving us.

We still have some indicators, but you get the richness from that full survey. As Catherine was saying, these transitions and flows in and out of the different states of unemployment, employment and inactivity give you real richness over and above the headline numbers, so it is really important.

Q1056 **Chair:** What are they, in total, telling you about wage pressures in our economy at the moment?

Andrew Bailey: This is just a point of numbers that may help to illustrate your point. The LFS suggests currently that employment is



about 0.2% above its pre-Covid level. There is another ONS survey, the workforce jobs survey, which suggests it is 2.8% above its pre-Covid level. Now, if you turn that into numbers, that is about a million people.

Q1057 Chair: The thing that caught you out on the way up with inflation was the number of people coming off furlough. That was an unpredictable moment, and I am just concerned that you do not have enough information. You are always making decisions in uncertainty, but this is giving you an enormous amount of uncertainty on such an important metric.

Sir Dave Ramsden: You are right to draw attention, in one sense, to that furlough period, but remember that that was an extraordinary labour market.

Q1058 Chair: I do not want to focus on the past. I just want to focus on now and the information you have.

Sir Dave Ramsden: What I am saying is that it is a different type of uncertainty now. We do not now have any of those policy interventions. We have had a period where, notwithstanding the uncertainties about the LFS, it is clear that the labour market has been very tight.

Back to your point, Chair, my assessment about wages is that the labour market is loosening. The wage growth you see in the range of surveys other than the AWE is about 7%, which is a very high level of wages, but it is less than the AWE measure, which is just under 8%. Forward-looking surveys suggest that wage pressures will ease, which is why we are forecasting that services inflation, which is very labour intensive, will come off its peak.

Andrew Bailey: If I just reflect, there is a basic story that needs to happen now, which is that headline inflation has come down and is coming down. That gets fed through into inflation expectations and it gets fed through into wage bargaining, wage settlement and pay rises. That is a mechanism that most models incorporate. To go back to what Catherine was saying earlier, if the labour market is tighter than we think it is, then that process is going to get more difficult. It is going to be disrupted.

To your question, yes, it is very important that we get as good a line of sight to this question as we possibly can, because it is a key part of what I call the last mile, this next phase to get inflation back down to target. If that mechanism works as it has in the past, then there is a pretty good probability we will be there. If it does not—and Catherine is right to have pointed out the concerns about it—then we are going to have more problems along the way.

Q1059 Chair: From a data point of view, though, you feel you have enough information to make that judgment.



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Andrew Bailey: The way I would characterise it is that we have a lot of information. The task, of course, is always to see through the thing clearly. The ONS is doing all the right things, but we need those things because that will help us to see more clearly.

Professor Haskel: Just to go back to the vacancy unemployment ratio that we were mentioning earlier on, that is a symptom of how we have changed the indicators that we look at. We have put more weight and less weight, over the years, on different types of indicators. As I say, the VU ratio has this property of being a leading indicator. Not only did we have it in chart 2.12, but in chart 2.14, just for the record, we have a whole wage equation, which we simulate using the VU ratio and so forth. That just amplifies Dave's point about how this is front and centre of what is in the MPR.

Chair: Thank you for surviving your colds and getting through the whole session. Thank you for your time as witnesses today.