HOUSE OF COMMONS

Treasury Committee

Oral evidence: Bank of England Monetary Policy Reports, HC 419

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Watch the meeting

Members present: Dame Meg Hillier (Chair); Dame Harriett Baldwin; Rachel Blake; Chris Coghlan; Bobby Dean; John Grady; Dame Siobhain McDonagh; Lola McEvoy; Dr Jeevun Sandher; Yuan Yang.

Questions 93 - 169

Witnesses

I: Andrew Bailey, Governor, Bank of England; Dr Huw Pill, Chief Economist, Bank of England; Megan Greene, External Member, Monetary Policy Committee, Bank of England; Professor Alan Taylor, External Member, Monetary Policy Committee, Bank of England.

Examination of witnesses

Witnesses: Andrew Bailey, Dr Huw Pill, Megan Greene and Professor Alan Taylor.

Q93 **Chair:** Welcome to the Treasury Select Committee on 6 March 2025. Today we are speaking to members of the Monetary Policy Committee about the Bank's Monetary Policy Report of February. I am really delighted to welcome Andrew Bailey, who is the Governor of the Bank of England. He is joined by Dr Huw Pill, who is the chief economist at the Bank of England. They are joined by two external members of the Monetary Policy Committee, Professor Alan Taylor, who was in front of us the last time we discussed this, and Megan Greene. A very warm welcome to you all.

There was quite an unanimity of opinion this time in the votes, but perhaps I could just go through each of you in turn and ask you to explain your rationale for why you voted the way you did and what considerations you had in your mind in taking that position.

Professor Taylor: I will maybe go through it at three levels. The first level would be global and historical, and how I saw the developments in that perspective. Then I will talk about the trajectory of the economy

coming through and out of 2024. Lastly, I will talk about four key data points that went into my thinking at the time of the decision.

The top level is the current local and global economic environment. I would just say we are living in an age of uncertainty. It is crucial to understand that. There is a longer-term part of that. If we look at the recent past, going back 17 years we have had six massive shocks: the global financial crisis, the eurozone crisis, Brexit, the covid pandemic, the Russia-Ukraine war and associated energy shocks, and whatever we will end up calling this period that we are living through. Those kinds of big shocks leave big scars. In a longer-run historical context, it is unusual that they have occurred so often in such a short span of time.

The effect of that, in economic theory and empirical research, is generally a trend in the behaviour of households and firms in the direction of "wait and see", of pausing big decisions and investments. That was the overall backdrop even in 2024, when I joined the committee, and it informed some of the answers I gave in November.

Taking a narrow focus on 2024, consistent with that view, there was decent growth early on, in the first quarter. There was expectation in the Bank and in the private sector forecasts that that would translate into some optimism; it would translate into growth; it would maybe unleash some animal spirits; there would be some positive feedback or a virtuous circle.

That did not materialise. Consumers kept saving; saving actually rose. Businesses continued to postpone investment. I heard that in Edinburgh in October. I was in Leeds in January and I was just in Bristol last week. It seems like that is a recurring theme in the second half of last year and into this year. There was an element of pessimism consistent with the precautionary backdrop.

How does that manifest? When you have uncertainty, it feeds through first into demand. People will defer consumption and investment. If it goes on for a long time, a decade or more, it will eventually feed into supply. If you are not making the investments and improving the capital stock, eventually you are going to pull down the rate of economic growth and productivity growth.

In 2024, we saw more of demand shocks dominating supply shocks, in my view. We had disinflation at the same time as weakening activity. That correlation is first-order evidence that demand shocks are dominating. We saw that in the sentiment. We saw that in the fall of vacancies relative to unemployment. We saw a modest rise in unemployment, rises in desired hours and some attrition in terms of employers, but no major redundancies yet. The output gap closed and we entered 2025 with slack appearing in both the labour market and the output gap.

In my personal view, which is different from the Monetary Policy Report, we probably have a bit more of an output gap than we have in the report. We had very big negative news between November and February. I would have put more of it into the output gap, but we put most of it into supply. That is a point of difference. Overall, that backdrop said to me that we should still be normalising policy gradually, but, as I said in November, to me, the risks were to the downside.

Okay, has that changed? Coming to what guided my vote in February, I will lay out four features of the data that I was weighing up. Two were in an encouraging direction and two were a bit more of a cause for concern.

Disinflation had continued, in terms of services inflation as well as the whole basket during 2024, as expected and kind of smoothly. We thought there would be bumps. There were, and there will be in 2025. We had already forecast that in November. We also got the agents' pay survey coming in at 3.7% for 2025. That is expected wage growth this year, which is substantially lower than the figure of around 6% which we had last year. Wage inflation is expected to trend down towards what is probably the ultimate sustainable long-run level of around 3%. Those are the positive notes.

The more cautionary notes were a bump in our inflation forecast, not due to supply and demand pressures, fundamentally, but due to one-time tax and administered price increases. Most importantly, the Ofgem price move contributed 0.4% to inflation. We also had a big increase in water prices because there is a front-loaded increase in the Ofwat tariff. There were also increases in bus fares, VAT and so forth.

Normally you would look through those kinds of one-time shocks and you would say, "That is a shift in the price level and not an indication of fundamental inflationary pressure in terms of a trend". If it was one of those shocks, 0.1% here or 0.2% there, you would be quite relaxed about looking through. When it is five or six of them—0.1%, 0.2% and 0.3%, and they add up to 1%—you feel a little more cautious about looking through all of them at the same time. You might have some concerns about whether that is going to feed through into inflation expectations and where it will take us next. That was note of concern 1.

Note of concern 2 was private pay growth in the AWE from the ONS. That had been falling smoothly throughout 2024, but in the final months it made an unusual U-turn. It looked odd to me. It did not line up with the other indicators that we use in the Bank, and it influenced my thinking. New data points may come along or possibly the past data will be revised, but until we get that it is hard to get a clear signal on the direction of travel of wage growth.

Summing up, those four pieces of evidence were in my scales. I saw both upside and downside risks, but I weighed them up evenly and thought, "We can stay on this gradual path". I saw no strong reason to hold—no one else did—and I saw no strong reason to go for 50.

Summing up, I did strongly argue for the use of the words "gradual" and "careful" in the statement, which is my way of saying, along with the middle of the committee, the median voter, that I see the risks as being two-sided because of this uncertainty that has widened, whereas the adjective "cautious" might be more associated with one-sided risk. I thought it was important to put that in the statement as a form of communication. Of course, that uncertainty has only widened from November until the February vote and then from the February vote up until now. Even in the last three or four days, it has widened considerably.

Therefore, we need to be attentive to all signals going forward. As far as I can see, every meeting coming up for the MPC will be a live meeting because that is the nature of things when you are making policy in a time of extreme uncertainty.

Q94 **Chair:** That is really comprehensive and helpful. You made a very interesting speech in January, and we were interested to hear what you said last time. In that speech, you weighted the probabilities of the three cases at 40% for the dovish case, 40% for the central case, and 20% for the hawkish case. Would you like to confirm those numbers? It would be helpful, when others answer, if they could give their weighting on those cases as well.

Professor Taylor: We will probably talk about this some more as we go on, but there are so many shocks happening right now that I would not move my central distribution much from there.

Chair: It would be odd if it had moved massively from January.

Professor Taylor: My certainty about any of those numbers has gone down significantly.

Q95 **Chair:** Megan Greene, we are keen to hear from you.

Megan Greene: My main message is that that the disinflationary trend we have had is broadly on track, even though we have this near-term increase in inflation in our forecast. You mentioned the three cases. We continue to be in a case 2 state of the world, which involves an output gap opening up to bear on inflation persistence and squeeze it out of the economy. Those two things really motivated my vote to remove some restrictiveness at our last meeting.

To my mind, the risks have shifted a bit since we started this rate-cutting cycle in August. As you will have noticed, GDP has roughly flatlined since March. How that affects your policy views really depends on how much you ascribe that to supply versus demand. There are reasons to think it is probably both.

As Alan mentioned, in our forecast treatment we have put a lot of that into supply. I am actually worried that it is even more in supply than what we have in our forecast. There is a narrative, which makes sense,

that suggests that policy uncertainty domestically and globally—higher taxes—might have weighed on demand over the past couple of months. My problem with that narrative is that, as Alan mentioned, we have seen AWE private sector regular wages tick up. They are volatile, but our own indicator-based measure for wages has also ticked up and all the other indicators are still pretty high. We have also seen some domestic cost pressures increase, particularly for food and core goods inflation. That is what I would expect to see if there were a supply constraint in the economy.

I am a bit concerned that there is a supply constraint now. Looking out through our forecast period, we expect supply to recover. There is a risk that productivity growth and potential growth therefore might not recover as we are expecting.

To my mind, the balance of risks has shifted since we started this rate-cutting cycle. Given the supply constraints, the risks have shifted away from a case 1 state of the world, where external shocks unwind on their own and inflation comes down, towards a case 2 or case 3 state of the world, which will require monetary policy to continue to bear down on inflation persistence.

Q96 **Chair:** Just from the two of you, there is lots that we are going to be probing later, particularly about some of the global shocks.

Andrew Bailey: Alan and Megan have put it very well. I will just pick out a few things.

My decision to vote for a cut was grounded in the underlying disinflation story still holding. This is why we use the word "gradual". The gradual erosion of the persistent element of inflation from the shocks that we had two or three years ago, or a bit more than that, is continuing. That is probably best illustrated by looking at core services inflation, which came down in the latest number. I say that because that is one of the better measures of what I call the underlying balance of activity in the economy. That is the grounding for the decision to vote for a cut.

As Alan said, we are, to state what I am afraid is the blindingly obvious, living in a world of even greater uncertainty than we were the last time we were here. I want to come on to that. I am rather more in case 2, with a balance on either side, than Megan is, but reasonable people can take those views quite reasonably.

There are four things that I will pick out. I will only talk about them very briefly because I am guessing we will come back to them. First, there is this question about activity and the fact that we have had very flat activity since last spring.

As Megan just talked about, the question is whether it is supply or demand. I would say two things there. First, it is quite hard to tell at the moment, but it is some of both. My view is a bit more balanced, in the

sense that it is a balance between supply and demand, but we clearly have to watch that story very carefully, as it evolves. The activity story and the uncertainty is the first one. I am sure we will come on this, but there is quite a lot of uncertainty about some of the numbers as well, frankly.

The second thing is, as we have highlighted—

Q97 **Chair:** Any particular numbers? We have talked about the labour force survey.

Andrew Bailey: The other thing I would add very briefly, because you may want to come back to it, is that last year we had an increase in the population, as estimated, some of which has come through into the labour force and some of which is yet to come through but will do in terms of how the ONS builds it in.

When you look at last year, put simply, we have a bigger population, but we have the same output and activity. The only way you can square those two things arithmetically is if productivity was weaker. In fact, last year we had negative productivity growth on the year. That is very unusual in a year when we did not have a recession. That would support a weaker supply side story, but it leaves you wondering what is really going on here, actually.

I am happy to come back to this one later, but I will just flag it now. There is also a question about public sector productivity and exactly what is going on there. The numbers are quite striking, but, again, how much is it real? How much is it measurement? Measuring output in the public sector is hard, statistically. That is an activity story.

As we highlighted, we do expect and are beginning to see a pick-up in inflation. Just to be clear, it is nothing like what we saw a few years ago. All of the reasons for the increase are due to a combination of energy prices, particularly gas—again, we can come back to that, if you like—some stuff on food, where there seem to be particular shocks going on, and administered prices, so water, bus fares, VAT on private schools and those sorts of things. Again, the reason I say that is that they are not telling you much about the underlying state of the economy.

The question we had to address was the old one: is this going to have second-round effects or not? Now, my view at the moment is that they are less likely. That is a contextual point, really. Set against a weakening pattern of the economy, they are probably less likely. However, since some of it is in energy and food—when you ask people what shapes their perceptions of inflation, those two things have quite a big impact because we all consume them most frequently—we have to watch that.

Secondly, you have the hangover effect from the last shock, with people saying, "Inflation is going up again, is it?" We have to watch that carefully. The third one—we may come back to this—is how the national

insurance change is going to feed through. The fourth one, obviously, is the state of the world at large. We may come back to that as well.

Chair: We are going to be coming back to that.

Andrew Bailey: If you put those four together, that is a lot of uncertainty. As Alan said, there are two-sided risks here. My two-sided risks have increased. That bears out Alan's point about uncertainty.

Dr Pill: Quite a lot has been said already.

Chair: You do not have to repeat it.

Dr Pill: I have not been here for a while because of the election. It is my first time with this group. If it is okay, I would quite like to start with a slightly bigger picture view and echo some of the things you have heard from Megan and the Governor.

It is important to recognise that the process of trend disinflation, following the very large pandemic and invasion-induced inflationary shocks, has continued over quite a long period now. A big part of the fall in headline inflation that we have seen, from its peak above 11% down to levels closer to but unfortunately still not at our 2% target, owes to the dissipation and in some cases reversal of those external shocks that originally drove inflation up.

It is also crucial to recognise that this process has monetary policy at its centre. There are two aspects to that. We have a monetary policy framework that has established price stability as its objective. It has expressed a clear quantitative expression of what that means in the form of the 2% inflation target. It has given the MPC independence to pursue that target. That has proved to be very important.

It has also been important that the MPC itself has established, in the course of 2022, a restrictive stance for monetary policy to bear down on inflationary pressures, as Megan described. Taken together, these two features have contained the second-round effects that threatened and have helped maintain the anchoring of longer-term inflation expectations at rates that are consistent with our 2% target. That has helped prevent the more lasting and more costly deviation from price stability that followed previous energy price shocks, such as those we saw in the 1970s. That is a topic that we have discussed on previous occasions with this Committee.

That disinflationary process has proved quite prolonged and proved occasionally bumpy. As others have mentioned, we are again seeing some upward pressure on headline inflation—in the short term, we hope—coming from further volatility in energy prices given by the uncertain environment and external events. I am sure we will discuss these later so I will not dwell on them right now, other than to note that they are a reminder that we do need to remain vigilant to new shocks

and disturbances that might threaten our path back to the reestablishment of price stability.

I will quickly turn to the recent decision. From my perspective, it is that continued progress with disinflation towards the 2% inflation target that created the scope for the MPC to reduce the restrictiveness of monetary policy and thereby to cut Bank rate a further 25 basis points at the February meeting. As you have said, that is a decision that I supported and voted for.

It is equally important to recognise that the success we have achieved in this disinflation process thus far does not mean it is complete. There continue to be echo effects from the large pandemic and invasion-induced inflationary shocks. They have not yet totally disappeared. That is reflected in the persistently elevated rate of underlying domestic inflationary pressures that we are seeing. That is illustrated in the continued strength of services price inflation and pay growth, among other indicators.

That is consistent with what Megan said about concerns of weakness on the supply side of the economy, suggesting that there is less slack and more resource pressure in the economy than some indicators, including perhaps the base case in the Monetary Policy Report, might suggest.

In my view, there is more work to do to squeeze those domestic underlying inflationary pressures out of the system. That entails maintaining some restrictiveness in the monetary policy stance. That points against both larger and more rapid cuts in Bank rate at this point. That is the basis for why I favoured a cautious and gradual approach to the withdrawal of monetary policy restrictiveness. That has really been the case for the last year. I spoke of this in the summer of last year. I have supported communication in that direction following the February MPC meeting. There is quite a lot of consistency and continuity in that approach.

Looking forward, my assessment is that further progress with disinflation would permit further withdrawal of monetary policy restrictiveness and further reductions in Bank rate over the rest of this year, but the magnitude and pace of Bank rate cuts has to depend on how the risks around that disinflationary path evolve.

I agree with the point that there are two-sided risks. On the one side, weaker demand would ease resource pressures and permit a somewhat steeper path of Bank rate reduction, but continued weakness in productivity growth or wider disruptions to the supply side of the economy, which perpetuate and intensify the nominal persistence we are seeing in price developments, cost developments and wage developments, would likely sustain this underlying domestic inflationary pressure in a manner that would require a slower removal of monetary policy restriction. That is the framework within which I am organising my thinking.

Just touching on the cases, I first talked about the cases back in July last year. I have not had the opportunity to talk about them here. It is interesting. When I first talked about them, I focused mainly on now what we call case 2 and case 3. That reflects where the bulk of my perspective is.

Chair: Those are the central and the hawkish.

Dr Pill: I have not personally changed my own view of the probabilities, which has been tilted that way for the bulk of this period. I see the data that we have seen over the last six to nine months not so much as a surprise, but more as a support of the view that I have maintained.

Q98 **Chair:** That is very interesting. It is hard to summarise four such eloquent economists, but we did note—it is reflected in what you say—that mentions of the word "uncertain" in the Monetary Policy Report have, interestingly, risen from 30 in August to 43 in November and 62 in February. You are all nodding. From what you have said, that is what is wrapped around the decisions.

Andrew Bailey: We have not counted them, but that seems fair enough.

Chair: You have been clear—Dr Hill mentioned it—that the 2% target is still in place. I am going to come to Lola McEvoy on that issue.

Q99 **Lola McEvoy:** Hello, everyone. It is nice to see you again. Welcome, Dr Pill. Just to go back on the 2% point, can you tell us a little bit more about your views on the 2% target? Are we still on track? What is your broader view on having an arbitrary target and how it is improving disinflation?

Dr Pill: In terms of the character of our target, there are two parts to it. First, why have a target and make it a very specific number? There are lots of benefits in terms of transparency and supporting the clarity of our communication from identifying a specific index and having a specific number that we associate with price stability. That has helped over many years, including in my involvement with the MPC and in our communication with this Committee. It helps to hold us accountable, and that is important.

Our ability to meet that target on a continuous basis is compromised by all these uncertainties and shocks that we face. It needs to be interpreted on the MPC side, on your side and, indeed, more widely in an intelligent way, recognising the uncertainties we face and the lags in our policy transmission process, all of which make month-to-month, let alone day-to-day, stabilisation of inflation of 2% pretty much impossible. That kind of medium-term forward-looking orientation remains extremely important.

I did recognise that you said it was a bit arbitrary. You are right, if you are pointing out the number 2% or the specific choice of the CPI headline index rather than any other. There is an element of arbitrariness in that,

although maintaining a consistent approach through time helps to bolster both the communication and credibility of those targets. It is not my job as a member of the MPC to set the target; it is the job of the Treasury and the Government, but none the less those are important features.

Crucially, going back to what I said earlier, having this target has been an important element through the quite challenging period we have had over recent years. It has helped longer-term inflation expectations in financial markets among households and firms remain well anchored. It has given clear guidance of what we are trying to do. We have committed and delivered on moving in that direction. We are making progress with that, as I have said. That stabilisation of longer-term expectations on the basis of the target is one of the key differences between what has happened through the course of this external shock episode relative to the one, which we have discussed on previous occasions, in the 1970s and early 1980s, which, as I also said a moment ago, turned out to be much more prolonged in its departure from price stability and much more costly to arrest.

In terms of what progress we are making, as you know, in the spring of last year we did get mechanically back to 2%. At the time, many of us on the committee did say, "Don't be lulled into a false sense of security". Just as there were upward impulses to headline inflation coming from very strong energy prices, a quite rapid fall of energy prices—albeit not back to where they started but none the less a fall—contributes negatively to the construction of the inflation measure that we target, and that will drop out.

That is what we have seen over recent quarters and months. That short-term volatility is beyond our control. We need to look through it. Several of us have made this point.

Q100 **Lola McEvoy:** You have said that it has helped mitigate the external shock episode this time. As we navigate uncertain times, will having the 2% target help with investor confidence?

Dr Pill: I very much think that. Our framework is based on a view of the world—fortunately for me, it is a view of the world I strongly share—that monetary policy makes its best contribution by stabilising prices and providing a credible forward-looking view that macroeconomic stability centred on achieving the inflation target will persist.

It is by taking out the unnecessary uncertainties, so uncertainty about policy, or uncertainty about the path of inflation and therefore both short-term and longer-term interest rates, that we create an environment for long-term decision making, whether those are decisions by firms about investment or by individuals about buying houses or education. All these longer-term decisions force you to think, "How much is it going to cost me to borrow? What is economic stability going to be like in five, 10 or 15 years' time?"

We are providing an anchor. Yes, it is difficult to take out all the things that we are facing in the world now. There is a residual uncertainty we cannot take away, but we can take away uncertainty about where inflation is going to be on that time horizon. That is the biggest contribution that we can make and are making.

Q101 **John Grady:** Ms Green, you gave a very interesting speech at the IoD a few weeks ago about trade and tariffs. This week the President of the United States has imposed tariffs on Canada and Mexico, and additional tariffs on Chinese imports. There is discussion about a 25% tariff on EU goods. How would you explain the impact of this to a family of non-economists in my seat of Glasgow? What would you say to them were the four or five key potential impacts of these tariffs on their lives?

Megan Greene: I would start off by saying how uncertain all of this is. We have seen things that have been announced that have been delayed or have not happened. We do not know how anybody will respond to this. There is a ton of uncertainty that you have to approach this topic with.

I would then think about the different channels through which tariffs might affect the UK economy. There are a number of them and they work in different directions depending on how other countries respond to them.

I would start off by looking at export substitution. If there are tariffs on the UK, for example, UK goods are relatively more expensive than goods produced domestically by the country imposing the tariffs. People might look for alternatives and stay away from UK goods. That would put downward pressure on demand for UK goods and so would put downward pressure on GDP and on inflation.

With that said, there might be a bunch of trade diversion as well. Countries that used to sell into the market that is imposing tariffs might not be able to do so profitably any more. They might look for other markets for their goods and might have to discount their goods a bit in order to find these new markets. That would put downward pressure on inflation in the UK.

The impact on GDP is not clear. If things are cheaper, consumers might buy more. At the same time, UK domestic producers might have a harder time competing with those imported products. That might be a wash on the GDP side.

You also have to look at exchange rates. To my mind, this is probably the most important and most uncertain channel, unfortunately. For example, if there were unilateral tariffs by a country such as the US, let us say, on the UK, economic theory suggests that the dollar should appreciate relative to the pound. That might be mitigated by the fact that lots of trade is already invoiced in US dollars. In any case, if that were to happen, it would put upward pressure on UK inflation and growth. If there were retaliation, however, that would put downward pressure on

the US dollar and the opposite would happen: you would see downward pressure on UK growth and inflation.

Like I said, this is a really important channel. Because the dollar is the reserve currency, it is unclear what would happen. For example, we saw tariffs unilaterally imposed yesterday and the dollar depreciated relative to the currencies of the countries that it imposed tariffs on. This is highly uncertain.

There are just a few other factors that I would think about. First, if you have trade fragmentation generally, you could have the reordering of supply chains. We saw during covid what that does to growth and GDP. It pushes down on growth and pushes up on inflation. As a result of trade fragmentation, you have less knowledge sharing and competition. That should push down on potential growth. All else equal, that would be inflationary.

There are all these different factors that you have to consider. What I tried to do in my speech was to use a model borrowed from the ECB to net them out. Ultimately, it seems likely that the implications for growth are fairly clear. It seems like tariffs would push down on growth. The implications for inflation, which, of course, is what we are primarily interested in, are much less clear. Net-net, if you think that exchange rates behave as the theory suggests, ultimately that should push down on inflation, but that is a key uncertainty.

Q102 **John Grady:** The struggle we all face is that we are trying to look into the future and none of us is perfect at that. On my layman's reading of table 1 in box C in the Bank of England MPC report—the section on the potential effect of tariffs—the balance of risks is that, while we do not know what it will do to inflation, the outbreak of tariffs and the potential for a trade war will ultimately lead to lower economic activity in the short and longer run, and less money in the pockets of my constituents in Glasgow as a result. Is that where the balance of risks lies, Ms Green?

Megan Greene: Yes. Accepting that there is a ton of uncertainty around this and that choreography is everything, it seems like ultimately there are more things that push down on activity for the UK than would push up. The implications for inflation are much less clear.

Q103 **John Grady:** As a quick-fire round—I don't want to get into trouble—Professor Taylor, would you agree with my reading of the situation that, for the money in the pockets of my Glasgow constituents, the downside risks are higher than the upside risks?

Professor Taylor: It is not just true for your constituents; it is true for people around the country and around the world. The Governor has also emphasised this. It is much easier to try to understand the effects of tariffs on activity, wellbeing, output and wages than it is to understand the directional effect on inflation, because that depends on many more factors.

In theory, are there certain circumstances where tariffs can make you better off? Yes, but they are very limited, such as if you are a large country with a monopolistic market power situation. That does not apply to the UK, really.

In that sense, if there are frictions being imposed by other countries, the extent to which we are caught up in that is going to reduce our opportunity to use trade. We are a country that trades a lot. Trade is, in a sense, another form of technology. You put goods in, called exports, and some other goods come out, called imports. That reflects comparative advantage, and it makes us better off in various ways. If you put sand in those wheels, we are going to be worse off on some margin.

Q104 **John Grady:** I have a question for the Governor. Against this uncertainty, if the US were to impose tariffs on the UK directly, what would be your three biggest concerns?

Andrew Bailey: You would have to see that in the context of the whole world. I very strongly agree with my colleagues on the effects of this.

I would say to your constituents that trade supports growth. Openness supports the spread of innovation; it supports the spread of ideas. Glasgow became a great city in the 19th century on the back of trade and the industrial revolution. You spend a lot more time in Glasgow than I do.

John Grady: You are always welcome to come.

Chair: He is buttering you up, Mr Grady.

Andrew Bailey: Alan is an expert, by the way. He has written on this stuff. If you go around Glasgow, you can see the evidence. You can see the buildings that this led to. Trade supports growth.

As Alan and Megan said, we had the experience in recent years of the threat to world security and the breaking up of supply chains. It is perfectly reasonable to ask whether this should cause us to reassess this just-in-time world trade economy. My view, however, is that it does not take away the benefits of trade and diversification. It means we have to take that into account.

Finally, what does the UK do? The key point I would make is that the place to solve these problems is in multilateral fora. I was in South Africa at the G7 and the G20 last week with the Chancellor. This is a point that I made very strongly. If we are going to solve these problems, there is a genuine point about balances in the world economy.

China has to answer the question, "Why is domestic demand so weak in China?" The counterpart to that is a very large current account surplus. Germany has the same issue, although in the last 24 hours Germany has done something quite radical—we may come on to that—in terms of the impact it has had on the markets today.

The US has to answer the question, "Yes, you have a current account deficit, but you also have a very big fiscal deficit. You are financing that current account with external capital". Alan has written a book on this subject, so I am going to defer to him. If you think the world economy is somehow out of balance, the place to address those balances is in a multilateral forum, not with bilateral action.

John Grady: You gave an interesting speech on this at King's College in Cambridge a few months ago, so we might as well turn to that. Trade disputes are ultimately litigated at the WTO, which is a global institution.

Andrew Bailey: Increasingly less so, I am afraid.

Q105 **John Grady:** You are quite right there. Two others are the IMF and the World Bank. There has been some discussion about the US withdrawing from the IMF and the World Bank. How damaging would that be to the UK?

Andrew Bailey: It would be a very damaging thing for the world. The new US Treasury Secretary has said that he believes in multilateralism, and I strongly welcome that. As I said in the speech in Cambridge, the world economy has changed a lot since Bretton Woods in 1944, but the lasting contribution that Bretton Woods made was the creation of the IMF, the World Bank and the multilateral institutions.

It is true to say that Bretton Woods was designed in a world—it was designed during the Second World War—where the US was the surplus economy and sterling was the reserve currency. You always read about the tension in Bretton Woods between Keynes and Harry White, who led the US side. That tension was about how to balance the world economy.

The reason I say that is that from the 1970s onwards the US changed from being the surplus economy to a deficit economy. The Bretton Woods system was designed asymmetrically by the US, so that the adjustment occurs in the deficit economies, not the surplus economies. Ironically, the US has become a deficit economy.

There is a perfectly reasonable question—it has been addressed many times without us coming up with an answer—as to whether we need to think about how the multilateral system works, given that change, but what is essential is that we do not abandon multilateralism. That is really essential.

Q106 **John Grady:** In summary, you would say we need to make sure that we keep, in Martin Wolf's words, international mediation between the grasshoppers and the ants, as he said in his famous essay.

Andrew Bailey: Yes. As ever, Martin put that in a very eloquent way.

Q107 **John Grady:** In your view, from a historical perspective, Governor, is what we have going on at the minute a passing storm or is it reflective of much greater turbulence to come?

Andrew Bailey: Alan asked earlier, "What are we going to end up calling this episode and how big is it going to be?" It is a big episode, actually. It really is a big episode. There is a major shift going on, certainly in the US. We have to take it very seriously and we have to be prepared to address it. I welcome what the Government are doing on that front.

We have to dig in at this point and ask, "How do we address these issues satisfactorily?" We cannot ignore them, frankly. Otherwise, as all of us have said, there are risks to the UK's situation and to UK growth. Megan is right to make the point that the impact on inflation could be ambiguous, but the risks to the UK economy and, indeed, the world economy are substantial at that point.

Q108 **John Grady:** That means a risk that people in England, Wales, Scotland and Northern Ireland will have less money in their pockets, ultimately.

Andrew Bailey: Yes, that is right. This is what we are here for. We serve the people and we have to take it very seriously.

Q109 **Yuan Yang:** Dr Pill, I appreciate the comments you and the other panellists have made on the uncertainty around the future trade tariffs and trade deals that are on the table. I want to ask a really specific question. In the event of the threatened steel and aluminium tariffs coming into effect next week, what is the game plan that you and your team of economists have right now to monitor that situation and the potential feed-through to inflation in the UK?

Dr Pill: As has been said, and as is reflected in the box in the MPR that has been referred to, we would need to work our way through the specifics of all of this. Many of my colleagues are examining the various options here.

The crucial element, which is the one emphasised by Megan, is that we have to see this through the lens of the system as a whole, not just through the lens of what any bilateral relationship may or may not be.

Indeed, our bilateral relationship in that area with the US is modest, but in a multilateral context, where we are importing from other parts of the world, how they respond to developments on one side of the Atlantic versus the other or, indeed, across the whole global economy into Asia becomes the key question.

That gets to the importance of understanding things through not just their direct effects but their overall effects. In particular, as Megan has said, if we were to see trade diversion, if countries are no longer competitive in exporting to certain parts of the world because those parts of the world have imposed tariffs on their specific goods, would that lead to a diversion into other markets, possibly including the UK market? That is the sort of uncertainty that would influence the short-term outlook for inflation through this route. Of course, those goods are important inputs into many parts of the economy, so that would have ripple effects.

I would emphasise—it goes back very much to what was said in response to the previous question—that the short-term ambiguity is about what happens to inflation. It is also true that fundamentally all these disruptions are disruptions to the efficient allocation of production, information sharing and capital across the world. Those types of things are what is going to undermine productivity growth, and productivity growth is the most important driver of the supply side of the economy, as Megan and I referred to earlier, and of the living standards we all enjoy.

Q110 **Yuan Yang:** You mentioned measures that you are already taking. Can you name some of the specific measures you use to pick up on the effects of trade diversion and so on? Have you changed your evidence-gathering methodology? Are there specific measures that you are taking?

Dr Pill: I would not say there are specific measures. We are collecting information. We are always looking at this information very closely. We look very closely, as a general rule, at developments in import prices by sector and we trace the impact of those.

Q111 **Chair:** You are not changing any modelling at this point.

Dr Pill: We have not changed our modelling at this point, no.

Q112 **Dr Sandher:** Governor, I want to ask you some questions around monetary policy transmission, the decisions that you guys make at the Monetary Policy Committee, and specifically its interaction with the APF and current reserve policy. You spoke about this a bit before, but I want to get your views on this a bit more clearly.

For the room, and for those watching, at the moment commercial banks hold reserves and the Bank of England remunerates those at the base rate. When you cut the base rate to 4.5%, you reduce the remuneration on those reserves, and that is the transmission mechanism.

What is your view on paying the policy rate on all the reserves and its impact on monetary policy transmission, specifically when the APF is operating as well?

Andrew Bailey: Paying Bank rate on reserves is the simplest and most efficient way to anchor the short end of the curve. You might ask the question, "When the MPC decides what the Bank rate is, what do we actually do?" As you just said, we change—or not—the rate we pay on our reserve accounts. That is the thing we do. Everything else follows on, as it were, and is a sort of follow-through from that.

It is the anchor, if you like, of the very short end of the interest rate curve. The monetary transmission mechanism follows. It is the most efficient way of doing that, in my view. It is a system that works efficiently. That is the answer to the first part of your question.

You mentioned the APF, which, in a sense, is the QE/QT piece of the picture. That is separate in terms of the rate that we pay on reserves.

The thing I would say there—stop me if I am interpreting the question wrongly.

Dr Sandher: I can clarify, if that is helpful.

Andrew Bailey: If you like, yes.

Q113 **Dr Sandher:** My concern is that there are at least two mechanisms by which paying the interest rate on reserves fully is damaging the monetary policy transmission mechanism. The first of those is that, on the one hand, you raise interest rates as the MPC and that gets paid out on all reserves. Commercial banks are receiving that interest rate, but they are also receiving a windfall payment that they were not expecting. On the one hand you are raising interest rates, which is supposed to reduce the money supply, and on the other hand commercial banks are receiving more payments than they were expecting and increasing their liquidity positions.

For example, the big four banks' profitability has gone up to £45 billion from £25 billion, which is almost double. Sir Paul Tucker has interest payments as part of the APF at £42 billion. They are working in two different directions. That is my concern.

Andrew Bailey: Can I say two things on that? I have quite often been asked in the past at this Committee about the way in which interest rate changes pass through particularly into the interest that depositors earn on their accounts. That is all part of the same system.

I made a speech at Loughborough University just over a year ago where I tried to set this out. The banks essentially target what is called their net interest margin. They have to earn at least the cost of their capital. A big part of that is the net interest margin. There is neutrality on the reserve accounts. In other words, we pay them the Bank rate, but we expect them to pay out on the other side of it. I know that rates do differ, but the point is that, if we did not pay them that, you would see that coming through into deposit rates because they do have to earn a net interest margin, which reflects their cost of capital.

Q114 **Dr Sandher:** I get that. That is not quite what I am getting at, Governor. I am saying that the banks have a better liquidity position than they are expecting. In fact, they have had an unexpected windfall payment. In 2021, they were expecting interest rates to be 1%. On the other side of it, the reserves that they hold all of a sudden pay 4.5%. They are receiving a lot more money each time you raise the interest rate.

Andrew Bailey: If you think about their balance sheets, the reserve accounts they hold with us are an asset for them. They are a liability for us and an asset for them. On the other side of their balance sheet, they have customer deposits, for instance. When we raise the Bank rate, their customers expect to earn a higher return on their deposits. You cannot just see it as a windfall for the banks in that sense.

Q115 **Dr Sandher:** It is only a windfall because of the APF. The difference in bond payments is why it is becoming a windfall for them. You are paying out this money to them. They are seeing their liquidity position expand.

My question is really about what the Bank of England has done around the monetary policy transmission mechanism. Has the Bank of England made an empirical assessment of this mechanism, by which you are improving the liquidity or equity position of banks through these reserve payments? Have you made an assessment of whether it is damaging or, indeed, impacting monetary policy?

Andrew Bailey: The APF is quite separate, if you do not mind me saying so. We spend a lot of time studying the monetary transmission mechanism. Our staff spend a lot of time on it because it is crucial to understanding monetary policy, as you said. Huw talked about the restrictiveness of our current stance on monetary policy. A very important way in which we assess that is through the monetary transmission mechanism. How is it working? We spend a lot of time on that.

These reserve accounts are there for two purposes. One is monetary stability and the other is financial stability. We also have to be very careful about the financial stability position. Going back to the pre-financial crisis period, I am afraid the error that was made in that period was that we had a stock of reserves that was much too low from a financial stability point of view. We want to run a system that maintains a stock of reserves that is consistent with both monetary policy and financial stability.

Q116 **Dr Sandher:** I agree about maintaining a stock of reserves. The question is about where we are at the moment. The specific question I had was around the empirical assessment. It is not just me; at least two CEPR papers have talked about this damaging effect. Their empirical assessment is that not having some tiering of reserves at this point in time, where these reserve payments are going to the other side and banks are seeing more payments and lending more, is damaging the monetary policy transmission mechanism.

Has the Bank of England made an empirical assessment of that? Is there any plan to do so in the future?

Chair: Have a go, Mr Bailey, and then we will move on.

Andrew Bailey: Can I suggest this? We spend a lot of time on the monetary transmission mechanism. I would be happy to go back and look at those two papers. I am happy to write to you.

Chair: Thank you very much, Governor. We appreciate that.

Q117 **Dame Harriett Baldwin:** My questions are for Dr Pill. Of the 12 recommendations from the Bernanke review, could you just update the Committee on how many you have already brought into your decision

making? How many are ongoing? Are any of them proving to be impossible to implement?

Dr Pill: A lot of work has been started and is being conducted in the aftermath of the report to implement those recommendations, which, as you say, have all been accepted.

What I would say and, indeed, have said in some of the public communication I did last year is that it is important to recognise that the strategy we have is a little like an iceberg. There is a lot going on beneath the water level, which is not visible to the outside. The fruits of the efforts that are going on there will only become visible in the course of this year.

Q118 **Dame Harriett Baldwin:** You have the opportunity now to tell us what is going on at the bottom of this iceberg.

Dr Pill: The reason I say that is that a lot of what is going on is probably the necessary foundational activities before the things that are perhaps more of interest to this Committee can be done. That is about setting up teams to address some of these things. It is about improving our data and IT systems to be able to introduce new modelling frameworks and represent more effectively the output of those modelling frameworks both internally and externally.

Of course, that is a natural precursor to improving the decision-making process along the lines that Professor Bernanke suggested. It will ultimately lead to how we might change our communication of policy. There is a natural sequencing here, where moving one part of that is both necessary before you can move on to subsequent parts of that chain and is very interconnected with those subsequent parts.

There is quite a lot of preparatory and organisational work taking place, which is, shall I say, less glamorous and perhaps of less interest to you, but is extremely important to ensure the success of the overall project.

Q119 **Dame Harriett Baldwin:** Have any of the recommendations become part of your way of working? You referred to the scenarios earlier, and I thought they might be linked to the Bernanke review.

Dr Pill: I spoke last July, as I said earlier, when we began to introduce this notion of cases that came up earlier. Those were introduced a little bit in the spirit of the scenarios that Professor Bernanke pointed to.

It is also fair to say they were introduced a little bit in a mode of experimentation rather than, "This is the answer to the essay question that Professor Bernanke posed us". That is the spirit of quite a few of the things that have happened, such as the way the monetary policy summary has been written. It is shorter. That was one of the Bernanke recommendations. It focuses less on the central forecast published. It is more a narrative discussion of where the economy stands.

We have made progress in implementation, but it is probably important to emphasise that I would not want any of the innovations that we have made to be seen as a definitive answer to one of the recommendations. We should see this as a whole.

Q120 **Dame Harriett Baldwin:** When can we expect the recommendations to have been adopted by the Bank?

Dr Pill: That is a progressive process. There will not be a day where we will say, "We are going to introduce five of the 12 recommendations today in a way that we have not done in the past". The work plan that has been set out envisages what is called in the Bank an agile approach, so one where there is some experimentation. That is embodied in the decision-making process. It is also embodied in the public communication.

Q121 **Dame Harriett Baldwin:** Does the work plan have an end date?

Dr Pill: The project that we have set up—of course, this goes to budgets and things that my boss sitting next to me is in control of—is a three-year project.

My own view of this is that we will make and are making significant progress, but for me a key message of the Bernanke report is that there are dangers in becoming complacent by thinking you have solved the monetary policy problem. The challenge really posed by the recommendations is to develop a learning and innovative culture in the Bank in order to ensure we do not fall behind the efficient frontier of producing monetary policy decisions, which we may have done in the past.

Dame Harriett Baldwin: That is probably enough on the Bernanke report today. We can come back to this in future meetings.

Chair: We can come back to it, yes. It is an area we will keep watching.

Q122 **Bobby Dean:** I was fascinated by the discussion at the beginning. My first question is perhaps directed to you, Professor Taylor. We were talking about the underlying disinflation, the second-round effects and the general uncertainty. The forecast is that inflation will peak at 3.7%. That would trigger an exchange of letters with the Chancellor. People might be surprised by the lack of alarm over the resurgence in inflation. Can you explain why there is not more alarm about inflation?

Professor Taylor: Do you mean alarm by me or by everyone else?

Q123 **Bobby Dean:** Everybody else might look at those figures and the process that triggers, and think, "Are we not just back where we were before?" I know you explained that a little bit in your answer earlier, but could you give us more context as to why there is not more alarm from the MPC about inflation?

Professor Taylor: For me, I said in my answer that what influenced my February vote on the concerning side was this change in the path of inflation. It was forecast to rise to around 2.5% in the November MPR. It is now going up to 3.7%.

What is the delta? What made that change? A lot of it is energy. Ofgem is 0.4% out of the roughly 1% or 1.2%. The other things are what we spoke about—the administered prices, the bus fares, the VAT and so forth. That is another shock of the same flavour as the energy shock we had before but much smaller.

Interestingly, we were looking at the gas curve and gas spot prices today. They are down to 104. They were as high as 140 a few weeks ago, reflecting geopolitical developments. Of course, to overuse the word we have been using all day, there is a lot of uncertainty about what comes next. One can imagine a future where gas prices stay at 104. Pre pandemic, they were around 40 or 50.

What is the normal level? What level will they get to? Under what geopolitical state of affairs will they get to that level or not? Will they shoot back up if there is some adverse shock? Historically, some of those energy prices are largely unpredictable. The curve may not be a very good guide.

One way to look at that is that it has gone up. It went up before. There is some reversal. Many of these shocks will fade at the horizon that is relevant for monetary policy. There will be price-level shocks, but we do not have a strong read on a directional trend and we hope there is not one.

For the non-energy components—water, bus fares, VAT and so forth—those are very much in the flavour of one-time tax increases. It is not like we are saying there is demand and supply pressure in the economy, which is a sign that the economy is running too hot and inflation is being pumped in from those economic fundamentals.

With that all being said, I listed that as a concern that balanced in my vote. If, going forward, it started to show up in any sign of second-round effects or in expectations, you would have to take pause. As I also mentioned in my answer, there could be a million other things going into the take pause bucket or the other directional bucket. Rates might need to go down more slowly; they might need to go down more quickly. That was the flavour of Deputy Governor Dave Ramsden's speech in South Africa last week. It is one of many factors. Maybe all the factors are alarming.

Megan Greene: I agree with what Professor Taylor said. To my mind, there are a few key differences between this near-term increase in inflation and what we have had in the recent past. First, it is going to 3.7%. That is not 11.1%. It is a smaller increase. Just as importantly, it is happening in a very different environment where the labour market is

broadly in balance and is actually loosening as opposed to tightening. Of course, I think monetary policy is restrictive, which it has not been in previous recent spikes in inflation. Those are key differences, but I would not want to give the impression that we are completely sanguine about this near-term increase in inflation.

The academic literature suggests people do not pay attention to inflation unless it is 4% or higher. Given what we have just been through, it is possible that the threshold for that is lower and people are a bit more sensitive to inflation. That is something we are certainly looking out for.

Professor Taylor: I completely agree. It is all those things. Is salience up? Maybe. Is slack up? Yes. We are going to be looking at all the indicators. That is why I said our meetings are going to be very live because we are going to be watching in real time for those signals.

Q124 **Chair:** Perhaps I can turn to Dr Pill. This is the second consecutive increase that we have seen. It is interesting. Professor Taylor has articulated very clearly the different reasons. Some of those are one-offs and therefore short-term. Do you agree with that? Is there a risk that we are underestimating the risk of inflation going up?

Dr Pill: You can have both. That is the concern. I would share a lot of what has been said by both Professor Taylor and Megan on the discussion of the impact of these one-off effects, which we do expect to see and which have been the main reason why the short-term inflation forecast looking to the middle of this year has risen substantially in the February MPR relative to the forecast the MPC published last November.

It is relatively mechanical, given developments in wholesale gas futures markets, developments in water bills and so forth. Those feed through in a pretty predictable and mechanical way to short-term movements in the headline consumer price index.

For me, the short-term challenge of that is not whether that will come through; it is more to interpret whether that will trigger these famous second-round effects. That is a concern.

I would say—this is perhaps where there is a bigger variance of views across the committee—there is a bigger distinction to make about how much of the echo effects, as I described earlier, of these big inflationary impulses, which took place post pandemic and after the invasion, and the big rise in energy prices that took place in that context, is still to be squeezed out of the system. I do not yet have full confidence that we have squeezed all of that out, so there is a question.

Q125 **Chair:** You are saying that it is about historic impacts, so you are not worried about the 2025 price shocks to the same extent. You seem to be minimising that, but there may still be long-term shocks.

Dr Pill: I am not sure that you can separate them in quite that way, but I do want to emphasise that, even if I was reassured—Professor Taylor has

made the point that wholesale gas prices have fallen quite a lot over the last week or so, on the back of information associated with geopolitics that we all know—that might mean that the outlook for mechanical dynamics in short-term inflation forecasts, say, going into the third quarter of this year could be lower than we had in the February projections. They might be 0.2% or 0.4% lower, so not dramatically lower, but lower than we might have had.

In that case, would I then sound the all-clear? I would be sceptical that it was the moment to sound the all-clear, because there is an underlying need to maintain the restriction in the system in order to squeeze that dynamic in inflation, which has been quite persistent over the last couple of years and has not yet been fully rooted out.

Q126 **Chair:** Governor, I appreciate that you might be constrained in what you can say as the Governor, but you have future rate-setting meetings. You have these shocks that have taken place this time. Professor Taylor and others seem to agree that they are one-offs—I am paraphrasing massively—and not likely to be a long-term trend. When will you know that that glidepath to 2% is secure? Are you thinking at all about how these world shocks that we are going through are going to have an impact?

Andrew Bailey: The difficulty, of course, is that the world keeps moving. I agree with what Huw just said. The one thing that I would add is to bring it back to this question of the balance of supply and demand, because that will influence the answer to the question that Huw has just outlined very well, which is how our judgment will evolve. The balance of the contributions of supply and demand—put simply, "Is it demand, or is it both supply and demand?"—will shape this question of the evolution of underlying inflation.

So far, as I said earlier, we are seeing gradual downward progress. As Huw said earlier, we are seeing better progress, frankly, than the record of the 1970s or early 1980s would tell us, so that is good news. It is, in large part, down to having these frameworks, having nominal targets and so on. How it evolves from here will very much depend on that.

This is why there are two-sided risks. We certainly had supply weakness last year. As Megan said, the labour market is in balance, but there are signs of it probably continuing to weaken in some of the surveys, although not really coming through into pay. As Alan was saying, our judgment on pay is relying a lot on the agents' survey, which, by the way, is historically a good indicator.

In answer to your question, I do not think that there is going to be a lightbulb moment when we say, "It is all over and we are going to 2%".

Q127 **Chair:** I am getting a sense that there is uncertainty, but not panic. "Panic" is probably not a word that you would ever use in the Bank of England.

Andrew Bailey: I would like you to think that you do not want the MPC to panic.

Q128 **Chair:** No, indeed. That was the wrong word, but you are all very relaxed about the fact that there are all of these global challenges.

Andrew Bailey: We take it very seriously.

Q129 **Chair:** You are taking these global challenges seriously, but you are still confident that you are on the glidepath to 2% that Ms McEvoy was talking about.

Andrew Bailey: At the moment, yes, but things can happen, as my colleagues have said. The underlying path is still downwards. I pointed to core services inflation earlier as not a bad guide to that. The underlying path is down. If anything—this is a personal view—the demand weakness argument may be getting a bit stronger relative to last year, but we will see.

Professor Taylor: There are reasons to be worried about both sides, as I have said. It will come back to the state of the labour market and wage inflation, which is an important component in the price of services. On a lot of that, we have backward-looking information in the AWE, which had that strange trajectory, but we are now going to get readings coming in. Those are the wage settlements for this year.

Chair: So, real data.

Professor Taylor: Right. In January, we had the agents' survey, which gave us a number of 3.7%. That was based on data collected over several months. Now settlements are rolling in—not very many, but a few. Most of them will come through maybe in March, but especially in April.

An interesting exercise that I did with my research team this week was to say, "Let's scroll back to last year. How did wage settlements unfold over those four months and what do we have so far this year?" It is interesting that what we have got so far—and it is a small sample—is coming in right on where the agents have said. If you went back to the corresponding months last year—January and February—and said, "At this point, this exact day a year ago, what would we have known?" those numbers were coming in at the high end of the agents' survey for last year. In a weakening labour market, as the months progressed, wage settlements came in at successively lower numbers. The early numbers were above the mean, and the later numbers were below the mean, which is what you would expect in a weakening labour market.

There is no guarantee that that pattern will unfold this year. It is still a weakening labour market, though. So far, we have a number that gives me reassurance that what the agents said so far has unfolded fairly accurately. That is the kind of information that we will be following in real

time, which will be a better guide for us at this inflection point and point of uncertainty than just relying on those backward-looking numbers.

Chair: That is really interesting. Thank you.

Q130 **Chris Coghlan:** Dr Pill, at the beginning, you were talking about inflationary echoes still being there and avoiding the mistakes of the 1970s, but wages are rising and productivity is falling. Is that not quite a strong inflationary indicator? How worried are you that we could repeat the mistakes of the 1970s by easing monetary policy too quickly?

Dr Pill: Just to emphasise—your question is a good prompt for this—my position on this is that we are on the glidepath. The scenario that you are just painting is one that would say, "We are no longer on the glidepath". If I thought we were moving in the direction of no longer being on the glidepath, that would require quite strong and immediate action, so it would lead me to depart from the gradual, cautious dynamic.

Going back to the Bernanke story, that is a different scenario. The way that I am interpreting the data now is that, in the big picture—that is why I tried to start with the big picture—we do see quite a lot of volatility month to month in some indicators rather than others. We may get to discussions of challenges with some of the data that we are using.

I would not want to be beholden to any single indicator in any single month. We have tried to shift our communication away from the sorts of key indicators that we were talking about 18 months ago, and more in the direction of these cases or scenarios, precisely because we want to tell an economic story. The economic story that I would want to tell is one not dissimilar to that which you just heard from Professor Taylor, which is that there is an easing in the economy that is reducing pressure on resources and allowing core services price inflation, pay growth and margins all to weaken. That is consistent with moving the dynamics of those indicators back to rates that would be compatible with the achievement of the 2% inflation target on a lasting, sustainable basis.

The discussion in the MPC now, as I read it, is about how intense those disinflationary forces are. The glidepath, therefore, becomes a question of how quickly we can follow down. It is fair to say—and this is what I tried to articulate earlier—that, while I do not doubt that the path of interest rates and the Bank rate from here is going in a falling direction, I would err on the side of caution.

To your point, it is true that we have seen weak productivity growth. It is true that we have seen headline AWE—average weekly earnings—and regular pay growth in the private sector rising in the last few quarters. We have quite a lot of information from looking at other indicators, cross-checking and so forth. In my language, there is plenty of reason for caution, but it has not yet accumulated to enough for me to change the scenario that I would see as the basis.

Chair: You are confident that you are on the glidepath. How steep that

path is depends on whether you are cautious or less cautious.

Q131 **Rachel Blake:** We have had a bit of a discussion about energy prices and their role in inflation. It has been established today that volatility in energy prices is now certain, and it seems to me that it is, essentially, baked in. What, if anything, can MPC decisions do to tackle energy prices?

Andrew Bailey: I am afraid that, of the influences on energy prices, we would come quite low down on the list. Let us put it that way.

Q132 **Rachel Blake:** That is what I thought you were going to say, so we are all on the same page. What are the drivers that you see?

Andrew Bailey: Of energy prices?

Rachel Blake: Yes.

Andrew Bailey: As Alan said, between the November and February Monetary Policy Reports, the spot price for gas, which is very salient for UK household consumption, went up about 20%. Since we did the February Monetary Policy Report, it has come down about 10%, mostly in the last week, as one of my colleagues was saying. That is the world that we are in.

Two or three things have influenced that. One is the geopolitical situation, particularly in the last week, with the greater prospect, I hope, of peace coming in Ukraine. We have had a colder winter in Europe this year. By the way, I use Europe geographically here. It is a single gas market, which we are part of, so the European price is relevant here. One of the things that benefited us in the last two years was that the first two winters after the Ukrainian war broke out were warmer than average in Europe. This one has not been. There have been some further supply disruptions, partly to do with Ukraine.

Those are the things that pushed it up: weather and supply disruptions. Hopefully, the greater prospect of peace in Ukraine seems to have had a beneficial effect on the price in the last week or so.

Professor Taylor: The price of energy is very far from anything under our control. It is a big exogenous driver of inflationary pressures. It takes the form of gas now; 50 years ago, it took the form of oil. It is a very big component in the economy; the economy runs on energy. If we were to live in a world with stable, certain, reliable and well-buffered energy in our economy, probably our job would be easier.

Q133 **Rachel Blake:** I am really pleased to hear you say that, because that leads on to my next question, which is about the point at which government investment in renewable energy might start flowing into energy prices. Clearly, the Government’s intention is to invest in renewables in order to stabilise our energy costs and to secure us nationally. At what point might we be able to see that stabilising these prices, which should then start to affect inflation?

Professor Taylor: I am not an engineer or an expert in that area, but talking about the inflation target and ways of setting up the regime, and thinking about the long-run history of attempts to achieve price stability, is interesting.

In the last 50 years, the only two times that we have seen a big test of inflation stability have been in the face of energy shocks. Those have been the big tests, and they have left imprints on the economy and our society. They have made people very unhappy, and I would say that they have reinforced the demand for inflation stability that has fed through into the current MPC arrangement, the independence of the central bank, and the inflation target that we are mandated to have. That history speaks to the major risks to our inflation outcome.

Andrew Bailey: There are two things on your question. I am afraid that we are not experts on either, so I will pose them, but I am not sure that I am going to answer them for you. One is the lead time on any investment to come through into productive capacity. We are not the experts on that.

The second is definitely a question that you should put to Ofgem, because we are not the experts on that. There is a marginal pricing system in energy. If you have a whole bunch of different sources of energy and ask them, "How do you arrive at the overall cap?" there is a marginal pricing system, and we are not the experts in saying, "When would that change?"

Dr Pill: On that, it is important to see that, in fact, there is a very mechanical dynamic in the current system. Gas price futures evolve in the way that they evolve. There is a mapping from gas price futures to the Ofgem variable energy tariff. That is very mechanical. We just heard, on 23 February, what that would be, based on futures prices and so on. The way that that is currently treated in the construction of the CPI that we target, in terms of the treatment of utility prices, which are about 4.5% of the total basket, is that variable rate tariff.

Andrew Bailey: The question also asked how much renewable you need to, in a sense, change the shape of the Ofgem cap setting.

Rachel Blake: That is exactly my question.

Andrew Bailey: It is a really good question, but we are not the experts on that one.

Dr Pill: Until and unless it changes that chain—

Chair: You cannot factor it in. It is a known unknown at this point.

Q134 **Rachel Blake:** So it is still too unknown for you. You are not the experts and you are not engineers, but you are looking at prices a lot. What I am hearing you say is that at this point, the stated desire for investment is not flowing through into any stabilisation. That is what I am hearing.

Chair: Into your forecast.

Andrew Bailey: It also comes through to the first point that I made, which is that you then have to factor in the lead time between investment and that coming on tap.

Chair: Even within the forecast, there are a lot more variables.

Q135 **Chris Coghlan:** Mr Bailey, how worried are you about the fall in UK productivity in the last year, in terms of this read-through to the recovery of UK productivity growth and the impact on the UK's fiscal position?

Andrew Bailey: Let me say two things on that. One is a bit longer term, and then I will come back to the last year. UK productivity growth has been very weak since the financial crisis. We are talking now about 15 years or so ago. By the way, the UK is not alone in this by any means; it is the case more often than not when you look across the industrialised countries.

The financial crisis was really a break in productivity. We had quite rapid productivity growth pre the financial crisis. We have had quite slow productivity growth since then. A point that I make quite often is that if you look at the UK potential growth rate, pre financial crisis it was typically 2% to 2.5% a year; post financial crisis, it is 1% to 1.5%, and that is where it is today. There are two things that make up the potential growth rate: labour supply and productivity. The change is due much more to productivity than to labour supply. That is the long-term context.

Going back to what I said right at the beginning on last year, I have to say that, in my mind, there is a real question. We have this negative productivity growth number for last year, which is unusual, and particularly in the context that we had last year. To what extent this is a product of the real situation, and to what extent it is a product of the way in which the data series are put together, is a very important question. Frankly, we do not know the answer to that question at the moment.

Q136 **Chris Coghlan:** Do you agree with Ben Navarro at Citigroup, who is saying that just a 0.1 percentage point fall in the productivity growth forecast could create a hole of £7 billion to £8 billion in the public finances?

Andrew Bailey: That is a question for the OBR, really, and not for us. We use their multipliers, if you like, and their effects, so that is a question that is best addressed to the OBR.

Q137 **Chris Coghlan:** Just coming back to your opening comments on national insurance, retail and hospitality businesses in particular in my constituency are telling me that there is an apocalypse out there on that. That was the exact word that they used. In the Budget, the Chancellor was forecasting 50,000 job losses from this. That seems fairly low to me in terms of what we are seeing, or is it too early to say?

Andrew Bailey: Perhaps it would be best if I just briefly described what we have been doing in the last couple of months, in terms of how we have addressed trying to get a hold on this question. We have the agents around the country, and we all go around the country a lot. As you can imagine, at almost every meeting that we have with businesses, this is a question that is prominent.

We have said before, but I will say again—we laid it out in the report—that this is an increase in the cost of employment. In terms of the channels it can then come through, we could see higher prices; we could see wage increases being lower than they would otherwise be; we could see lower employment, either in numbers or in hours worked; or we could see lower profit margins. Of course, those things are not mutually exclusive, so we could see all of those happen. When we ask firms, that is exactly the answer that we get: "We will do all of them".

Just to add to that, some of these things can happen sooner than others. Wages are stickier than prices. Employment is somewhat stickier than prices. Profit margins are the residual. Firms do seek to influence them, but that is where it goes, if it goes nowhere else. In the report and in the forecast, we said that we thought that the make-up of the channels would shift over time to reflect that. That is the first point that I would make.

The second goes to your point about hospitality. Having talked about the wage channel, for those businesses that employ more people whose pay is set, effectively, by the increase in the national living wage—hospitality being a case in point—one of those channels is very much blunted by that. I am not saying that in any sense pejoratively or critically. It is an observation. That channel is less open to a firm that has more people on the national living wage.

Q138 **Lola McEvoy:** In the Monetary Policy Report, you mention productivity. I am fascinated by this. All of you have mentioned productivity in the economy. I would really love to get a straight answer about what is going on. We have asked several witnesses over the course of this Committee, and we would really like your professional views on what is causing this problem.

The Monetary Policy Report says that there is "significant uncertainty around estimates of slack in the economy, particularly at a time when the precise factors accounting for weaker activity are not clear". Please can you elaborate on that?

Chair: Who would you direct that to?

Lola McEvoy: It is to the Governor, as well as to Ms Greene, just because you mentioned it. I am just really keen to hear what all of you think are the factors causing this uncertainty around what is going on.

Andrew Bailey: There could be quite a few answers. I will offer a few thoughts, and my colleagues will come in on the productivity story. When

I said that we were not dissimilar to most other countries, the one exception on the headline number is the US. Manufacturing productivity in the US is, basically, as flat as it is here. Going back to Mr Coghlan's question, it has been over the last 15 years, and the same is true for last year. What is different in the US is that there appears to be a much bigger contribution from the growth sectors of IT and technology, so that may be one part of the story. Secondly, can I come back to the public sector point briefly?

Q139 **Chair:** Yes, because you mentioned that earlier, and the lack of measurements.

Andrew Bailey: The ONS released some numbers a few weeks ago on this. It is both striking and puzzling. I think that I am right in saying that, if you take the start point as the end of 2019, immediately pre covid, and you compare it to now, the level of total public sector productivity is about 8% to 9% lower. You grimace, but you are going to grimace even more when I say what I am going to say. In the health sector, it is about 17% to 18% lower.

It is very hard to measure output in the public sector. It is much harder to measure output than it is in the private sector. Without criticising the ONS, it does it in a somewhat different way from other countries, but it is often described as a leading way. It tries to, in a sense, measure stuff, whereas the traditional way is to take nominal spending, deflate it, and come up with a real estimate, so there is no assumption on productivity growth at all. I said this at the Monetary Policy Report press conference, and I was accused by one newspaper of saying that the public sector was bloated. I am not passing judgment whatsoever at this point, if you do not mind me saying that.

There is a real question: is this real or is it something to do with measurement, given everything that has gone on? Your question about productivity is a pretty critical one. I got my colleagues to do a back-of-the-envelope exercise and asked, "If you just hold public sector productivity constant going back to the end of 2019, or put it on the trend that it was on over the last 10 years up to then, what difference does it make to total GDP in the economy?" Depending on the assumptions that you make, it is in the order of 1% to 3%. This is not trivial at all. Exactly what is going on is a big question. I will now finish with the plea that we always make. We are not the experts on this, but it is a really big question.

Q140 **Lola McEvoy:** Is it real or is it a data analysis problem? We had witnesses from the ONS, and they were sure that there was a productivity problem. That is fair, isn't it, Chair? They gave us their absolute confidence that the data that they are collecting is correct. Are there any other factors that could be causing this in the data analysis reading that you are aware of?

Andrew Bailey: The answer is, "I don't know". They are the experts. It is hard to measure the quality of output in the public sector, because it is not priced as such. That is the first problem.

Secondly, we had this during covid. This should have gone away, but take the health sector. We do it a bit differently in the UK, in that we count things, such as trips to the dentist, surgical procedures and so on. The traditional way is that you take the nominal spend and deflate it. One reason why UK output fell more during the covid period than in other countries—and then, of course, it recovered—was that the things that were counted in the health sector stopped happening. We were not going to the dentist, for instance.

That made it look as if output in the health service had fallen, but, of course, it had not. As we all know, the NHS was absolutely at full stretch and doing a great job, but it was not captured by the measurement system.

Chair: They were not doing elective operations.

Andrew Bailey: I just do not know, because I am not an expert, so it is all very well for me to sit here and say this.

Chair: There are plenty of people who crunch health datasets.

Andrew Bailey: I just do not know what the story is.

Q141 **Lola McEvoy:** Let us leave health to one side, because you have said that you are not the expert, but it is very interesting to hear. From what you have said, since we are no longer in a pandemic and people are getting their appointments now, we should see a rebalancing of those measurements that were previously calculated. If we park health for now, what is your analysis of the other sectors where we are lagging behind? You said that it is the public sector, but health is 18% behind.

Andrew Bailey: Manufacturing productivity in the UK does not look very different from that in other countries.

Megan Greene: There is certainly a question around measurement of productivity growth. If you look at recent data, there are other suggestions that there is a supply issue. We have just reweighted population. It is not the labour supply, which means that, mechanically, it must be something to do with productivity growth.

We look at a few things. One is surveys on companies' capacity utilisation, which are just below historical trends, even though we have a small negative output gap, so that does not suggest that it is all demand. It suggests that there might be a supply issue as well. We also have top-down measures of output gaps that do not suggest additional spare capacity is opening up. Again, that also shows that maybe there is a supply issue.

It is easy to say, "It's all just measurement; it's really hard". Productivity in the public sector does not fully explain why productivity growth was so weak last year. Taking a step back, you might consider, "If it is just measurement, you would not think that supply was an issue", but there are other reasons to think that it might be an issue. It is probably not labour supply, given the increase in population, so it must be something to do with productivity growth. That gives you no narrative on what exactly is happening with productivity growth, but it does suggest that it is probably not just a measurement issue.

Q142 **Lola McEvoy:** The measurements worked before 2019 and we were doing all right then. We have seen the hit from the pandemic, but, if we were using those measurements again, it does not really explain the sole reason for the lack of productivity.

Megan Greene: Yes, and you could argue that we have had measurement problems for decades as well.

Q143 **Lola McEvoy:** Do you have anything else that you want to elaborate on or are desperate to say to this Committee on the supply point?

Megan Greene: There is just one more thing that I would say about supply. Barring a pandemic or a war—something that comes and really hits you in the face—it is hard to explain supply, because it tends to be slower moving. While we can observe things such as productivity in real time, it is much tougher to come up with a narrative of the kind that you are asking for, but that does not mean that it is not there.

Andrew Bailey: The other thing that we should refer back to—Huw follows this very closely from our side—is this question about exactly what the labour supply is, and the labour force survey. This particularly relates to the question of participation in the labour force. It is a question about how many people are inactive, as it is put, in that they do not have and are not seeking a job.

Chair: We are going to touch on that.

Andrew Bailey: That is another part of this whole story.

Chair: You have been very trenchant on that from Mansion House onwards.

Q144 **Rachel Blake:** Just to follow up on health sector productivity, you talked about whether it is real or a measurement challenge. Let us say that it is real. Is there any analysis around this being connected to the complexity of health challenges that this country faces?

Andrew Bailey: We really are not the experts on that one. I do have very interesting conversations from time to time with Chris Whitty on this subject.

Chair: He is acting Permanent Secretary at the Department of Health.

Andrew Bailey: Yes. They are the experts. It is a fascinating question, but not one that we can help on.

Q145 **Yuan Yang:** I have a series of questions about the data. First, Mr Bailey, can I just clarify that I heard you correctly when you broadly said that, at present, you do not know whether the productivity decrease last year is a facet of the revised ONS data or whether it is real? Is that your broad view?

Andrew Bailey: In my mind, there are question marks around it. We have had these revisions for population. It is perfectly reasonable that we get those. They have partly been fed through into the labour supply numbers, but there are still some more to come at the end of this year. In other words, of the already announced population increase, it has not all been put through into the labour supply. The unusualness of the position last year does raise questions about it, but no more than that.

Q146 **Yuan Yang:** When we spoke to the ONS and Sir Ian Diamond, the national statistician, last month, he told us that he was "very confident" about the labour force survey data and, in particular, the data on inactivity. I was wondering if I could go through the panel and ask, on a scale of "not very" to "very confident", how confident you are in the ONS data from the labour force survey that you are receiving right now.

Professor Taylor: There are known problems with the labour force survey, which I do not need to rehearse. We could have a better picture if we had more information. That is always desirable. There have been independent studies from other sources saying that there could be a range of plausible numbers for what inactivity might be. It might not be as bad as the official numbers. There is a range there. I am not an expert in this area. Directionally, it has gone in the direction of more inactivity post pandemic. As for trying to understand the magnitude, I do not think I fully understand it myself yet.

Q147 **Yuan Yang:** Are you very confident in the inactivity data?

Professor Taylor: Moderately.

Megan Greene: I would say that better data is always better. We know that there are issues. The response rates have improved over recent months, so that is something to point to. Also, we do not rely on just the LFS data; we would not even if it were perfect. We would always look at a range of series.

Q148 **Chair:** Where is your level of confidence?

Megan Greene: I am moderately confident.

Andrew Bailey: It is moderate. The challenge that we have with the point about other data sources is that it is hardest with inactivity. There are fewer substitutes for inactivity. We are very supportive of the work that the ONS is doing, which is the right thing to do. There is no question about that. I have to say—this may go back to Alan's point about having

a range—that the work that the Resolution Foundation has done was dismissed a bit quickly in that commentary. I am not saying that it is right, necessarily, but it is a serious piece of work. Let me put it that way.

Chair: The atmosphere in the room was interesting at the time.

Dr Pill: As a high-level response to the question, I am moderately confident, and my confidence is improving. I would echo, and will not repeat, the remarks made about looking at a broad set of data, including unofficial data, or data generated by surveys, including ones that we conduct ourselves. That is important. The idea that we are unable to form a view on issues around employment growth, unemployment levels and the state of the labour market has, on occasion, been overstated.

It is not for me to put words in the mouth of the national statistician, but it is true that, in the aftermath of the pandemic, we saw participation rates in the LFS fall very dramatically. We will never be able to reconstruct that period, because we have moved on, so there is a Bermuda triangle element to this, but the ONS did implement this restoration plan.

Chair: Yes, we have gone into this in a lot of detail with them.

Dr Pill: Because of the wave or longitudinal structure of these data, the fruits of that plan being implemented last spring will be coming only in this month's data.

Chair: Dr Pill, forgive me if I cut you off, but we have gone through this in detail with them, so we do not need to repeat it here.

Dr Pill: It does seem to me that that is the basis of that statement. We engage a lot with our friends and colleagues at the ONS. It is important to emphasise that our benchmark for quality is not perfection, because perfection is unattainable, but a good benchmark for quality is a pre-pandemic level of quality. I would be sceptical, as I think my immediate colleagues in the economist pool would be too, that just getting back to this restoration in May will re-establish the level of quality that we saw prior to the pandemic.

Q149 **Yuan Yang:** So you are sceptical about whether the current measures to improve the quality of data will get us back to that pre-pandemic benchmark.

Dr Pill: Yes. Our view, which I would endorse—when I say "our", I mean my colleagues; these are my colleagues too, but I mean the colleagues I work with on a day-to-day basis—is, in line with the ONS view, that the so-called transformed labour force statistics, which is this initially internet-based survey, is the way forward and really the way out of this. The transition to that has taken longer and been more painful.

Chair: The ONS would agree with you on that particular point.

Q150 **Yuan Yang:** I realise, Mr Bailey, that we did not quite ask you what your

level of confidence is right now.

Chair: You did say moderate.

Andrew Bailey: Yes, moderate.

Q151 **Yuan Yang:** When you spoke to us in November, you said, in relation to the labour force survey, "We do not know how much faith we can put in it", which, to me, speaks to a level of not much confidence back in November. Has your confidence risen since then?

Andrew Bailey: It goes back to what Megan was saying. There are parts of it we can cross-check much more easily against other data sources. If you said to me, "Are you confident on unemployment?" I am reasonably confident. The cross-checks seem to bear out—

Chair: The DWP has its figures for claimants.

Andrew Bailey: Yes, quite. It is particularly this question of inactivity and participation where I have more questions, if I can put it that way, because there is so little ability to cross-check that one.

Dr Pill: There is a letter that I wrote to my colleagues at the ONS.

Yuan Yang: Is this the May 2024 letter?

Dr Pill: Yes. In this letter, we set out a set of requests. It is fair to say that the reweighting of the LFS on the basis of the interim population estimates, which is what the Governor referred to earlier, has been completed. Also, with the move in May to publishing the March data for the post-restoration plan, we will have better flow data. Those two things are quite key to our understanding of the type of analysis that we do—for example, constructing measures of NAIRU, the non-accelerating inflation measure of the unemployment rate, which are quite key to our forecasting process.

Q152 **Yuan Yang:** Are you satisfied, Dr Pill, that your requests in that letter have been or are being satisfied?

Dr Pill: I am satisfied that they are being satisfied. As I say, there is a two-sided element to this. We want to see a quality of data that we found acceptable, which is the pre-pandemic quality of data. We do not think that the implementation of those measures will deliver that. What we do think, though, is that the TLFS is the answer.

In a constrained resource situation, which, clearly, the ONS faces, there may be a need to put more of the resources that it has into this space, and we—or at least I—would endorse that approach. It would be counterproductive to expect it, for example, to do a repeated interim update of the population weightings, based on the interim population estimates that we had earlier this year, at the expense of making progress with the TLFS. It is a good economic question about how to allocate scarce resources.

Chair: Yes, indeed, and we had that out with the ONS witnesses when they were with us.

Dame Harriett Baldwin: The characterisation that I would give to the evidence that we have heard today is that we have a UK economy that has managed to survive a range of shocks over the last few years, but it is an economy that is really just surviving and not thriving. Productivity—particularly public sector productivity—has not been demonstrating the same sorts of levels that we have seen historically.

I just wanted to probe that a bit further. Into this context, we then have a Budget at the end of October, where a further £350 billion of public spending is announced, funded by borrowing, to some extent, but also by a £25 billion increase in tax on businesses, primarily through national insurance. Governor, you very kindly sent the Chair a letter referring to the questions that I asked you last time about the transmission mechanism.

Chair: It is published on the website.

Q153 **Dame Harriett Baldwin:** It has just been published on our website. It is about national insurance contributions and trying to disaggregate them, but acknowledging that, of course, businesses will react in the four ways that you described earlier.

I thought that it was a very interesting letter, because, clearly, we can observe that businesses are reacting in those four ways. You highlight in your letter that there is limited capacity for businesses to take it on the chin through profits. Am I correct in understanding your wording around that?

Andrew Bailey: I attempted to do the "what if?" calculations, which I think was the original question. I should say, and I did point this out in the letter, that they are all a bit heroic.

Q154 **Dame Harriett Baldwin:** Have I understood that correctly? Is it a yes to that first question?

Andrew Bailey: The point that I was making is that, if you did the "what if?" and if it was concentrated in one channel, that would be quite noticeable.

Q155 **Dame Harriett Baldwin:** So it is limited as to how much can happen through that channel. That is what your letter says.

Andrew Bailey: We do not expect it all to come through one channel, as we said earlier.

Q156 **Dame Harriett Baldwin:** You then said that there has been an impact, in that businesses have been able to react to the tax increase by raising their prices. You quantify that in your letter as being between 0.1 and 0.2. Have I understood that correctly?

Andrew Bailey: We are still in the world of assumptions. We put something in the November report and, essentially, continued that in this report, but this is still very much an assumption, not fact.

Q157 **Dame Harriett Baldwin:** There has been a non-zero impact from the Budget on inflation.

Andrew Bailey: Yes. Indeed, as we have said, we expect this to show up in an effect on inflation.

Q158 **Dame Harriett Baldwin:** They could react by reducing nominal wages. You have said that some of the transmission will happen in that way, and you are picking up some of that in your data. Am I correct in understanding that as well?

Andrew Bailey: Yes.

Q159 **Dame Harriett Baldwin:** The sentence that I thought was particularly interesting in your letter was where you say that, because there is a limit to the amount that businesses can pass on through reducing their profits, and it is difficult for them to pass on the increase in consumer prices in full, in terms of their costs, it "may point to the risk of stronger responses through the labour market".

We can observe in the data that jobs are being cut at the fastest rate since 2008. Professor Taylor, your quote earlier was that we have not yet seen major redundancies, but you did acknowledge that there has been a weaker labour market. Governor, I wonder if you could quantify, further to the question from my colleague Mr Coghlan, the number of jobs that have been lost directly as a result of the Budget increase in national insurance.

Andrew Bailey: I cannot, because it has not yet happened.

Q160 **Dame Harriett Baldwin:** It has happened to a lot of people. We have seen a lot of announcements of job losses.

Andrew Bailey: Yes, but we have to separate that from the general weakness of demand and the economy that we were seeing last year, which predates the Budget, so we would be a bit careful in that. What I would say—and this may be helpful—is that, when you look at the surveys that are being released at the moment, there is certainly a weakness in employment intentions.

If you look at the purchasing managers' surveys, or the recruitment surveys that are published once a month, you can see a weakness, but let me just reiterate the point that we have seen a softening of the labour market going on from before the Budget, so there is more than one thing going on here.

Q161 **Dame Harriett Baldwin:** The Office for Budget Responsibility forecast that the Budget would cost 50,000 jobs. Is the Bank of England's forecast different from that?

Andrew Bailey: In terms of fiscal impacts, we use the OBR's numbers, so we would not tend to adopt anything particularly different. It will be coming out with a new forecast quite soon, so we will see what is in that.

Q162 **Dame Harriett Baldwin:** Have you seen anything in the data that you have seen so far that would make you believe that 50,000 was not a correct forecast?

Andrew Bailey: What I would say is that, when I go around the country talking to businesses, they talk about all the channels, as I said earlier. They talk about looking at both employment numbers and hours worked, because you can adjust in two ways. We are certainly picking that up, but you cannot easily aggregate that up to say that it is or is not 50,000, so I am going to wait and see what the OBR thinks on that one.

Q163 **Dame Harriett Baldwin:** You must have a view at the Bank of England. You have all these smart economists and all these forecasts. You must have a forecast for what you think is going to happen to employment.

Andrew Bailey: You can see the path that we have put in the forecast for unemployment. That is one way of looking at it.

Q164 **Dame Harriett Baldwin:** How many is that in terms of actual jobs?

Andrew Bailey: We have a reasonably flat path this year for unemployment, so it is still around 4.5%.

Dr Pill: One thing that is quite important in this context is that, by contrast with the OBR, we do not do a forecast on a pre-measure/post-measure basis.

Dame Harriett Baldwin: You take it as given.

Dr Pill: We are not doing a separate forecast of this. It has to be seen in the whole. That is why separating out the marginal effect of this on employment is not really part of what we look at.

Chair: We have the OBR in front of us on 1 April.

Andrew Bailey: People have to notify redundancies. They are aggregated, and we have not yet seen a pick-up in notified redundancies.

Q165 **Dame Harriett Baldwin:** We have seen jobs being cut at the fastest rate since 2008, haven't we, Dr Pill?

Dr Pill: On some measures, yes. Some of these survey measures have the character that the Governor was talking about. As he also says, that has not been shown up in the redundancy notifications. The issues around employment growth and so forth are at the heart of the debate about the quality of the labour force survey, so the official data. I do not want to repeat all of that argument again, but there is a degree of uncertainty.

What we can say with some certainty, which is an interesting combination, is that there have been a set of surveys undertaken, including by the Bank, but also by the CBI, which have explored this issue about what margins of adjustment will be adopted in the face of this change in the tax situation. Those surveys, as one would expect, suggest that all the margins that were described by the Governor are being employed.

Q166 **Dame Harriett Baldwin:** I understand that. In an economic model, if you increase the price of employing a person by £900, and they are not expecting it, do you have more or fewer people employed?

Dr Pill: In our economic model, we have fewer people employed. The point that is quite telling from these surveys is that the level of activity in the economy is going sideways. That is consistent with elements that we have discussed. Employment and employment intentions do look weak, but price intentions look quite strong.

That would suggest that—consistent with some of the survey evidence asking specifically about this, but placing it in the broader context that Megan has tried to do by thinking about supply and seeing this over a longer horizon—the combination of weakness in activity and employment, with strength in some of the nominal dynamics, is probably associated more with concerns about supply, which would tend to drive up prices while activity is weakening, rather than concerns about demand, which would tend to move prices and activity in the same direction.

Q167 **John Grady:** Ms Greene, charts 2 and 3 in your very interesting paper illustrate the essential truth that we are a very open trading nation. The US and the EU are our two biggest trade partners. By the way, the data shows the same for Scotland.

Andrew Bailey: I would say that England is the largest trading partner for Scotland.

Q168 **John Grady:** It is, of course, but we are all part of one United Kingdom. It is ill advised for either of us to stray into that territory. No good will come of that. Are there any other international shocks or factors? We have elections in Canada, which your predecessor might have an interest in. France has gone off the radar, but, of course, politically, it is not a paragon of stability at the minute. There are significant increases in defence spending. There is the situation in the Middle East. Is there anything else on the radar that you see, Ms Greene, as having potentially a material impact on inflation and the work of the MPC?

Megan Greene: As you saw in my speech, the UK is most exposed to the EU from a trade perspective. I would say that what was announced last night in Germany is potentially quite transformative for spending. It will go to the Bundestag next week, of course, but it is the first time that I have been really surprised in my professional life by Germany and its spending. This could be quite a sea change in terms of public borrowing and spending in Europe, which should have spillover effects for the UK.

The second biggest trading partner is, of course, the US. There is a lot going on there. It is not just trade that impacts the UK from the US, but also financial markets, so that is another connection that I would highlight.

Q169 **John Grady:** Professor Taylor, do you have anything to add to that?

Professor Taylor: There are quite enough factors on my list already, but I would say that, at this very moment, the uncertainty over trade policy is very important. I wanted to emphasise that it is not just other countries' choices; it is our choice about how or whether we retaliate, and what measures we put in place against which countries. We have a choice there, and that will be extremely important. That is outside of our bailiwick, but it is an important thing to get right.

Chair: Thank you. We could debate this for another couple of hours, but we will give our witnesses a break and pause it there. Can I thank you very much indeed? In summary, we have heard a lot of interesting things, but, primarily, that we are living in an age of uncertainty and that the Bank is making policy in this age of uncertainty.

We have also heard very clearly from the Governor that if the world economy is out of balance, the way to resolve it is in a multilateral rather than a unilateral context. Governor, you warned about the risks to the world economy if multilateral institutions such as the IMF are weakened or compromised. That is a very important message that you have put on the record there.

Of course, tariffs imposed by the United States are very much in everybody's minds and are more likely than not to reduce incomes in the UK, so that is something that we are all very concerned about.

Can I thank you very much indeed for coming? A transcript of this session will be available on the website, uncorrected, in the next couple of days, so thank you to our colleagues at Hansard for that. Thanks to our colleagues at Bow Tie for the broadcasting. Thank you very much indeed.