



Economic Affairs Committee

Corrected oral evidence: Annual scrutiny session with the Governor of the Bank of England

Tuesday 24 June 2025

3 pm

Watch the meeting

Members present: Lord Wood of Anfield (The Chair); Lord Blackwell; Lord Burns; Lord Davies of Brixton; Lord Lamont of Lerwick; Baroness Liddell of Coatdyke; Lord Liddle; Lord Londesborough; Lord Petitgas; Lord Razzall; Lord Turnbull; Lord Verjee; Baroness Wolf of Dulwich.

Evidence Session No. 1

Heard in Public

Questions 1 - 16

Witness

I: Andrew Bailey, Governor, Bank of England

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Examination of witness

Andrew Bailey.

Q1 **The Chair:** Welcome to the committee's annual evidence session with the Governor of the Bank of England. We are delighted to welcome Andrew Bailey, the Governor, today. Thank you very much for your time. This is being broadcast on parliamentlive.tv. A full transcript will be taken and we will make it available shortly afterwards so that any corrections can be made.

I start with a question about the geopolitical moment we are in and the effect on the UK as you see it. Current forecasts clearly already point to modest growth. There is heightened geopolitical uncertainty, changing by the day it seems. Could you give us a sense of your concerns about the UK economic outlook as affected by those geopolitical movements?

Andrew Bailey: Well, it is interesting. I was reflecting before we came in that, if we had had this hearing 24 hours ago, I would have probably told you a somewhat different story from the one I will tell you now. Just overnight, we have seen quite a big change in the situation, which, honestly, I would not have predicted necessarily. That is a good way of saying that we often get preoccupied by lexical language in the MPC. For a long time, we have used the word "uncertainty". We have introduced "unpredictability" as well. There is an important difference there. As I look at it, "uncertainty" is a situation where you can use the past as some guide but there is a varyingly large degree in the range of possible outcomes; "unpredictability" is where you really cannot use the past and it does not provide you with much of a guide. I think that is certainly the way we would look at the situation on trade and tariffs at the moment. We have seen, so far, rather a big turnaround overnight in the situation—certainly with, for instance, the oil price.

If we step back from that for a moment, I will say some things to open up. First, focusing on the tariff issue, it is very unpredictable where this will all end up. Clearly, we are coming towards the end of the 90-day period that President Trump set out for reaching agreements. We have one agreement so far, which is with the UK. That has not been implemented yet and that is it at the moment. Quite where this will go, I am afraid we do not know at this stage. That is one reflection.

Stepping back to the economics of that side of things, fragmenting the world economy is bad for its activity and growth. There is a sort of balance in the current situation because we have seen in recent years what can be the negative effects of disruption to supply chains. It is not the only source of disruption, but fragmenting the world economy is bad for activity and productivity growth. Without as much trade, it is bad for spreading innovation, for instance.

The effect on inflation is much more ambiguous, frankly. It depends on what the consequences are and over what time. If, for instance, the imposition of tariffs was to lead to the redirection of exports from, let us

say, China to other countries including the UK, that could have a downward, disinflationary effect. If, on the other hand, the effect is to disrupt supply chains, that could go the other way. It is pretty ambiguous. I am sure we will come on to the domestic situation, but the consequence of this is that when thinking about my decisions on interest rates, because of the sheer unpredictability, it is not that I ignore the world—anything but. However, I do not put that high a weight on it, because, frankly, it is so unpredictable at the moment that, as we saw in the last 24 hours, it can easily change overnight.

To illustrate what we have seen in the last 24 hours, there has been about a \$10 a barrel fall in the oil price. The West Texas price is about \$65 as we speak and was about \$75 at the weekend. We saw it go up as the hostilities started, but I think this takes us back to about 5% above where we were at the beginning of May. We are probably a bit below where we were in February. The gas price has not moved much. Yesterday afternoon, when I first read that Iran had fired missiles at Qatar, it suggested bad news, but then the oil price promptly went down. We seem to be in a slightly different world here, where these hostilities break out but are rather controlled: "I've sent missiles your way. Will you shoot them down? If you do, that will be okay". It is a very different world; let me put it that way.

The Chair: There are different kinds of volatility. That is one of the lessons we have learned. What have you learned over the past few years about what the Bank can do in times of great volatility? How do you spot the difference between markets adjusting and being so volatile that, for stability reasons, Bank intervention might be needed?

Andrew Bailey: We have learned a lot over recent years. It is a good question. First, you are right: volatility can cause financial and market stability problems, but it may not be as prolonged as you might expect so as to cause deeper macroeconomic problems. One thing we have learned in recent years is that we had to expand our toolkit for dealing with these things to make a clearer distinction between them.

Looking back over recent months, certainly back in April we saw quite elevated market volatility. There were two moments in particular where I thought we were looking, globally, at quite a difficult situation. Those were two moments when, I would say, the US Administration stepped back. The first was when the 90-day tariff window came in and the second was over the question of Chair Powell's future at the Federal Reserve. On both occasions, things got quite difficult and then there was a step back. We saw during that period a lot of short-term change in market positioning, particularly in the hedge fund-type world. We have to follow that very closely. We did a market-wide exercise with a whole range of participants last year to simulate this type of stress event, particularly in highly leveraged markets. We saw some of that type of activity in April, but it did not come to a point where there was real stress in the markets and we were watching it very carefully.

Moving on to now, people in the market tell me pretty consistently that there is a shift in longer-term investors, and we are watching for that. Going into this over recent years, many international investors have been overweight in dollars and overweight in the US because the US has had a good story over the past 10 years, economically speaking. They were also often unhedged in terms of their exposure to the dollar as a currency because, again, it was a pretty stable situation. That was not a bad position; in recent history, it was a pretty good position to take. We are now seeing that change and investors reassess. This is not a massive dedollarisation; it is reassessing that slightly overweight position and moving to hedge their positions because they see the correlations in markets changing quite rapidly. There are those two things. That will take time to work through because these are longer-term investors who move more slowly.

The Chair: That is interesting, thank you.

Q2 Lord Blackwell: Can I push you to be a bit more specific on your expectations for inflation? We have been told that the Bank of England model always regresses back to 2% in a period of years. How confident are you that you have the tools to deliver that? What are the main things you will look at in managing monetary policy over that period?

Andrew Bailey: I will just make the point that when it comes back to 2%, it does so because we have an interest rate path there. There are a whole set of judgments on interest rates embedded in that, of course, which are part of bringing it back.

Where are we currently? Obviously, we have had rapid disinflation from the problems we had two or three years ago. Our focus has been on what are called the second-round persistence effects. How much of that would we see and to what extent did we need to maintain interest rates and policy in a more restricted fashion to push down on that persistence? Our approach since last summer has been to gradually reduce that restrictiveness of policy as we think we have seen that fairly gradual disinflation take place. It has been careful because, frankly, and as I will come on to, some things have not moved as we expected.

We have seen more recently, particularly in the last couple of months, although we were expecting to see it for a little while, what we tend to call a "hump" in inflation. Inflation has gone up from around 2.5% to around 3.4%. The causes of that are entirely things that do not really reflect the balance of supply and demand in the economy. They are what we tend to call "administered prices": a combination of energy prices, which have the Ofgem process in there, water bills, vehicle excise duty, private school fees and all those things. To be clear, all inflation is inflation. I am not trivialising this. I am saying that that does not tell us about the underlying state of the economy, which I will come back to. The question then, of course, is how long it will take to pull that out. It is an annual calculation. Will we, once again, see any second-round effects from that, and what stance of policy do we need to maintain to offset that?

Coming back to the point I made on the Chair's question earlier about how much weight we put on domestic considerations versus global ones, for me the domestic considerations are much more important. What is the context at the moment—the backdrop, if you like—to that question of how quickly the hump will come off and we go back to target? This is where you get a range of views on the committee. My own view is that we are starting to see softening of the labour market. That is the message I get when I go around the country talking to firms, which I do quite a lot. Pay increases are still well above a level consistent with the target. However, I get the message pretty consistently that they are coming off. Our regional agents do an annual survey. The one they did earlier this year said they will come off. So far, the evidence suggests that that picture is in place.

You then get the question, for instance, of the national insurance contribution increase and how that gets passed through. Again, when our agents, my colleagues and I go around, I always lay out a menu of things that can happen to firms. I say, "Well, obviously, you can raise prices. You can squeeze margins, reduce your labour input, have wage settlements lower than they would otherwise be or increase productivity—although that would take some time". Of course, you could do all those things; they are not mutually inconsistent. There is always the question of whether you are getting a representative sample. Anecdotally, in recent weeks and months I have heard more firms tell me that they are making adjustments on the labour market side, in both quantities and prices. I get that story a bit more than we did before this came into effect, when people were speculating more on what they would do.

That is the context of the situation. I think we are seeing an economy where some slack is opening up. That is why my view is that the path of rates is still downward but it will be very gradual and careful. As I say, we have this hump and we must see that come out, but that context is very different from the one we had three years ago. In a sense, that is what motivates my decisions. At every meeting we have to come back to this but particularly with what is going on in the world around us.

Lord Blackwell: We have a question coming up on the labour market so I will not ask you more about that. A lot of people have been interested in the past in the link between money supply policy and the growth of money supply.

Andrew Bailey: Yes.

Lord Blackwell: It grew at 3.5% or more over the decade but slowed down recently. Could you talk a bit about your preferred measure, what its recent performance has been and the impact it has had?

Andrew Bailey: I think I may have said last time I was here that my preferred measure is the ratio of M4 to nominal GDP. As things stand, this is now a bit below its pre-Covid trendline. It has come off quite a lot and is a bit below. I find that more useful than the month-by-month

movements, which can be quite volatile and have all sorts of stuff going on in there. The staff always come up with some explanation of the month-by-months, with something going on in some bit of the non-financial world. But I find that ratio a more helpful backdrop, in a sense, to reading the money supply side of things.

Lord Blackwell: You said it is at about the same level as it was pre-Covid.

Andrew Bailey: It has come off and is a bit below that. If you put Covid to one side and look at the trendline pre-Covid up to 2019 and extrapolate from that, it is a bit below—not a lot and falling slightly.

Lord Blackwell: What weight does that have in any of your thinking?

Andrew Bailey: It does have weight. It is another factor that I take into consideration. It is another read on the underlying condition of the economy and tightness of conditions in it, so it has weight in my reading.

Q3 **Lord Burns:** Good afternoon, Governor. I will press a little further on what Norman has said and move on to the issue of the possible path of interest rates. In the most recent minutes, a phrase used a lot is the present “restrictive” stance. How is the word “restrictive” in this sense measured? Is it something to do with where real interest rates are relative to the expected growth rate of the economy?

Andrew Bailey: Yes.

Lord Burns: Is it what you think is the level that will reduce the growth of nominal GDP? Is it informed by the money to GDP?

Andrew Bailey: Yes.

Lord Burns: The phrase crops up a great deal, as if it were the most obvious thing in the world.

Andrew Bailey: It does, and obviously it is important.

Lord Burns: Yes, I know.

Andrew Bailey: It is an assessment of the impact of monetary policy.

Lord Burns: That is the effect of it.

Andrew Bailey: Going back to Lord Blackwell’s question, it is important in terms of the effect that policy is having. There are many ways you could get at this question. Let me lay out two which are quite normally used and tell you why I prefer one of them. The one I am not so keen on is to ask the level of so-called R^* , the equilibrium neutral interest rate, and then where we are relative to that. There are a whole range of so-called star variables, which are the equilibriums. You can have equilibrium unemployment, equilibrium output and so on. The problem, certainly with R^* , is that if you do any estimation of it there is quite a big error band. It is also dependent upon prevailing conditions. I am not a

great fan of the idea that there is some sort of permanent or long-term measure of R^* and we can assess where we are. Going back to what I just said, there is also a division between what I call long-term and short-term measures of R^* . The short-term one is more cyclical, the long-term one more structural. Which one do you go for? I do not find that so helpful.

Our staff do a lot of work in assessing the impact of the level of interest rates on what is called the monetary transmission mechanism. They spend a lot of time, for instance, looking at things like the mortgage market, corporate borrowing, what effect the path of interest rates is having and, moreover, what effect we think it will have looking forward. That is important. Take the mortgage market as the most obvious case: it has changed structurally a lot over the last 10 or 20 years to a system where, predominantly, mortgages are now on five to seven-year fixed terms. Again, you have a very different path of resetting people's mortgage costs. The staff do a lot of assessment of how past interest rate rises pass through, what is still to come and the profile of adjustment of people's mortgage costs over the coming years. Of course, some will go up and some will go down, depending on when they last reset and what the term is. They add all of that up. That is where I get the thing that policy is restrictive currently. We try to gauge how restrictive. That is my preferred way of looking at it.

Lord Burns: This month, three members voted for lower interest rates. One has systematically voted for rates below the majority; the other two have from time to time. Is there any way to describe what significant things divide you?

Andrew Bailey: If you go back to the previous meeting we had people voting the other way, on the upside. Going back to the labour market, there is a range of views on the committee as to how much that has adjusted. Huw Pill set this out very cogently in a number of speeches. He asked whether we have seen a structural change in the labour market post Covid which is making it more inflexible.

Going back to my point about star variables, I think you would then ask whether that has raised the equilibrium level of unemployment. You raised the question about those on the other side. I think they would take the opposite view: Swati Dhingra, Alan Taylor and now Dave Ramsden would probably say that they feel they have seen more adjustments in the downward direction and are more confident that we are on the downside of that, so felt more confident to vote for a cut. It is a combination of those things. Are there structural rigidities in the labour market? That feeds through into the so-called equilibrium variables.

Secondly, I think this was a reasonable range of views. There are probably also members of the committee saying, "Look, we're beginning to see the labour market adjusting but will that be passed through to inflation?" To use the technical term, sometimes they said, "Is this a tale of two Phillips curves? The wage Phillips curve is adjusting but we haven't yet seen the evidence for the inflation Phillips curve". Now, the counter to

that is, "Well, you wouldn't necessarily expect to because one will lead the other, so I would not read too much into that". That is a debate on the committee—which, by the way, is perfectly healthy, in my view.

Lord Burns: Yes, I am sure. The other phrase that caught my attention was that monetary policy is not on a "preset" path.

Andrew Bailey: Yes.

Lord Burns: Is that about timing or direction, or is it just a hedge against the fact that, as you discussed at the outset, there may be many surprises around the corner and we just want to wait and see how they play out?

Andrew Bailey: Yes, it is another way of expressing the term "gradual and careful". We do not want to give the impression that there is a preset path because the uncertainty level is so high.

Lord Burns: You hint at some expectation that we are on a downward path.

Andrew Bailey: I have been very clear that I think the path leads downward and will continue to do so. As you can imagine, I would never give a prediction about what the next meeting will do anyway, but, in these circumstances, we are particularly careful about what we say on that front because the world is just so uncertain.

Q4 **Lord Liddle:** How do you think Britain is performing relative to other countries? Successive Chancellors have, at various points, said, "Oh, we're doing very well", on the basis of a quarter's figures, and then it has not looked so good. Where would you say we are relative to the United States, the eurozone and the principal European countries?

Andrew Bailey: I will give you a more immediate view and a long-term view because I think they are both important. On the immediate view, we have emphasised for some time that although we had a pick-up in growth in the first quarter—which was welcome—we were quite concerned that underlying growth did not show the same pattern. That was for a few reasons. First, we were not getting the same reads out of the business surveys; they gave a more cautious read. Secondly, we looked at what I call two key components of demand in the economy; I will start with consumption and then go on to business investment.

The story of consumption is that, for over two years now, we have had a positive increase in real household incomes as we have come out of the inflation period and wage increases have stayed higher. Interestingly, that has not come through to household consumption in the way that you might expect from models based on history. That is another way of saying that the saving rate is high in this country at the moment, by historical standards. The question then is why it is high and what we expect it to do in future.

On why, a survey is done periodically and I think, first, it is certainly a reflection of people rebuilding the real value of their savings after the inflation experience. Secondly, going back to Lord Burns's question, policy is restrictive and therefore interest rates are higher, and that is more attractive. By the way, people do not say something that if you go back in time to various points in the past they have said: that they do it for fear of losing their jobs. They do not say that at the moment. The point is that consumption is weak relative to that underlying pattern. The question we really face is what we think will cause that to change. I think you would expect it to change at some point. You do not tend to have high saving rates going on for ever but it is a judgment.

Business investment brings us back to the opening question on uncertainty in the world. There is a reasonably well-established relationship in economics between uncertainty and investment, in the sense that because investment is typically a once-off, irreversible decision that firms have to make, in the face of increased uncertainty the option to wait becomes more attractive. Certainly when I go round the country talking to firms, as I do, I hear that a lot at the moment. They are pausing investment decisions because of the level of uncertainty around. Again, I think the trade tariff issue plays into that. That is the shorter-term position.

On the longer term, it is interesting that you asked about comparisons. I have just talked about demand in the economy and we also have to judge whether it is demand or supply. Now, supply is where the longer term helps. The UK is really not that different from many other economies here. If you go back in time to before the financial crisis, the typical rate of potential growth in this country was about 2% or 2.5% a year. Since the financial crisis it has been about 1% to 1.5%. That pattern is not unusual, to your point about comparisons. The US is rather the outlier in having stronger potential growth. When you look at the two things that make up potential growth—growth of labour supply and productivity—that decline is much more about productivity than labour supply. You can link productivity back to investment. The UK has had a weak investment story for some time.

There is an underlying story of weak potential growth here. You see it in other countries, though. The UK is not unusual in this respect. There is an underlying story of weak investment. There is a very important question, which we may come on to, about what we need to do and what will change that underlying story. To finish, when we take monetary policy decisions, in a sense we have to assess the balance: to what extent is it weak demand or weak supply and weak demand? They have different implications for inflation.

Lord Liddle: On the international comparison, Germany has done very badly in the recent period. Would you expect it to recover strongly in the coming years?

Andrew Bailey: Again, Germany's structural story is weaker. The interesting question in Germany now is that it has announced a very big

change in the stance of fiscal policy there. That is primarily related to defence spending. The big question now is to what extent that will feed through and change this position on the supply side of the economy. It certainly could do.

Q5 Lord Razzall: Governor, I was tempted to ask you about quantitative easing but I think you have seen off Richard Tice of Reform on that topic.

Andrew Bailey: I have written, I hope, a full answer to his letter, let me put it that way. By the way, that is an important issue as well.

Lord Razzall: I know, so I will ask you about quantitative tightening instead. Could you comment on the appropriateness of this in the light of the current economic outlook and the adequacy of reserves in the financial system?

Andrew Bailey: Let us take those two questions together. We do not regard quantitative tightening as an active policy tool. Bank rate is the active policy tool. All our staff analysis suggests that we do not think quantitative tightening is having, on its own, a large impact on market conditions but we always reassess this. We are about to start the annual review any day. That builds up to the announcement we will make in September. As we do that, we will go back over that question. It will be more interesting this year because we have had quite a steepening of the yield curve, but then we have seen that, frankly, in all the major economies so I do not put that down to quantitative tightening. As I said to the Treasury Committee in the House of Commons the other day, we will have to look at the interaction of these terms because it is slightly new territory. We will have to come back to that question, but we set bank rate after taking everything into consideration, including any impact from quantitative tightening. I think that is the appropriate way to have done it.

Of course, the aim of quantitative tightening is in two parts. One is that we bring the level of reserves in the system down to the sort of equilibrium level demanded by banks. We are a bit under £700 billion now, having come down from, I think, about £970 billion. Again, it is like another of these star variables: we do not know what the equilibrium level of reserves is but we ask the banks regularly. We have a range, and the top end is about £550 billion. If that is the case, we are about £120 billion or £130 billion off the top end, but I am sounding overly precise there.

The second leg of quantitative tightening, which I laid out in a speech at the LSE last year, is to continue to, in a sense, change the Bank of England's balance sheet as we get to that equilibrium level of reserves. That involves the assets on the other side from the reserve accounts. Frankly, we transfer the interest rate risk out into the market, so it is not on our or the public's balance sheet. That would be the objective thereafter because I do not think it is appropriate to have that on our balance sheet going forward.

With reserves, as you said, I have gone into this question extensively in my letter to Richard Tice. My point is that we are moving to a demand-driven reserve system. The main reason for those reserves is financial stability, not monetary policy. We could run the system with quite a low level of reserves for monetary policy. We did so for about two years before the financial crisis. Financial stability is a different story. Reserves are the ultimate form of cash liquidity. However, the banks have choices because actually what we set for them is what is called high-quality liquid assets. They have to have a certain stock of high-quality liquid assets to match their deposits. Reserves are one form of those but there are also gilts and other forms of bonds. They can choose what they hold. The point I made to Richard Tice is that, if you change the pricing of those assets, of course they will make different choices. Ultimately, if we do not remunerate the reserves, there will not be any other than the minimum we would need for monetary policy purposes.

Moreover, as I also said to him, bank profits are a matter of judgment but I made the point to him that both sides of our balance sheet are remunerated. We are not making a loss on those activities. It is a pass-through and we use that to essentially anchor Bank Rate for the purpose of monetary policy transmission, going back to Lord Burns's question. It is neutral in that sense.

Going forward, I think this is a sensible system. For the banks, it means that they are now returning to a point, a long time after the financial crisis, where they are earning their cost of capital. That is important for the banks because it is essentially what the market expects, quite reasonably. You can see that because their price-to-book ratios are now just a bit above unity. Essentially, if they are below unity something is wrong; either they have very bad balance sheets or there is something structurally wrong in the system.

Lord Razzall: I have two quick follow-up questions. It sounds as though you agree with the *FT* that the reserve landing zone on QT is likely to be arrived at quite quickly. Secondly, do you agree with your colleague Catherine Mann that there is no obvious answer to the right place at which balance sheet sizes should be dealt with?

Andrew Bailey: If this estimate that we get from the banking system is near, then we will get there at some point in the second half of next year, probably. By the way, it is not just determined by quantitative tightening; we have another thing going on. During Covid, we advanced something called the TFSME—funding for small and medium-sized enterprises—that supported the banks lending to them. That is running off so it is reducing reserves as well.

Lord Razzall: Do you have an idea of the preferred minimum rate of reserves?

Andrew Bailey: As I said, the range has an upper end of somewhere around £550 billion. If that is right, we will get there in the second half of next year on current trends.

On Catherine Mann's point, we do not have a preferred number. We have a system with enough reserves for monetary policy, which is pretty small, and that maintains sufficient reserves to achieve financial stability. In that system, I prefer that in among this stock of high-quality liquid assets they maintain a decent stock of reserves because it is the most liquid form of asset if they face liquidity pressures. With the others, they have to come to us and do emergency operations to liquefy them or go to the market to do it.

Q6 Lord Londesborough: Good afternoon, Governor. Can we focus now on the state of the UK labour market? You mentioned earlier in response to Lord Burns's question that there was a range of views within the MPC on labour market dynamics. To what degree is the current state of the labour market a force of uncertainty in terms of policy formulation? We have unemployment ticking up and vacancies continue to be very subdued.

Andrew Bailey: They are falling back.

Lord Londesborough: I think they have fallen in 36 consecutive months. Latterly, we have had some quite alarming data, subject to revision, I am sure, on payroll employees from HMRC suggesting a fall of more than 100,000 in the month of May alone. How much agreement is there on the MPC regarding wage dynamics? Which particular variables are getting the focus of the Bank?

Andrew Bailey: Just on your point about that data, you are right that it came with a big health warning from HMRC. It is useful data but always with that health warning about the immediate month ahead because it goes up.

Lord Londesborough: We have a follow-up question on that so I will not steal Baroness Liddell's thunder.

Andrew Bailey: Looking more broadly, it is important. As I think I mentioned earlier, the backdrop to this involves two things. The labour market is softening. Pay, as set out in the AWE survey, has been at levels well above what is consistent with the inflation target. We are beginning to see that come off. Our agents, who do a survey early on every year, said that they thought settlements this year will be around about 3.7% on average, having talked to firms. That is down from 5.4% last year. My judgment at the moment is basically that that number is intact, in the sense that I think we are seeing settlements coming down into that territory. The AWE is more of a lagging number, so it is coming off but is not there yet. There is uncertainty. As I said, some of my colleagues are more concerned. They are not yet convinced that we are not seeing structural issues in the labour market.

You also mentioned unemployment and that is important. The challenge we have there is that the bigger part of the story now is inactivity rather than unemployment. Just to be clear, somebody who is unemployed has not got a job and is searching for one; somebody who is inactive has not

got a job and is not searching. Inactivity went up during Covid. That was true for many economies. On the face of it, it has not come down in the UK but here we get into the problems of the Labour Force Survey. As you were saying, we can proxy unemployment from other sources. Our staff will say, "Look, we can give you a pretty good read of unemployment using sources other than the Labour Force Survey". You cannot really do that with inactivity. The Labour Force Survey is the source of inactivity data, and so there is a question there. There is also a question as to whether we have seen some structural shift—whether there are now more people inactive than unemployed relative to what you might have seen in the past.

Inactivity is coming down as measured but has not come down as much as in other countries. There are some pretty concerning aspects to this in a broader public policy sense—not really for me, but the fact that there are more young people reported as inactive is concerning. From our point of view the question is what that tells us about labour supply going forward. Does it mean that we have a smaller pool of labour available and seeking work, or could we see people coming out of inactivity and moving back into the pool seeking work? That is a difficult judgment to call at the moment.

Lord Londesborough: Following up on economic inactivity, I believe the current rate is 9.2 million. That is an improvement of 300,000; it has dropped from 9.5 million a year ago. How does this number shape your overall thinking about the labour market and potential growth? Do you expect this number to increase or decrease, looking ahead?

Andrew Bailey: The long-run backdrop to this is that we have a population that is, on average, ageing. This is typical of industrialised economies, so there is nothing particularly unusual about the UK in this respect, but that is the backdrop to the point about labour supply. I have to stress the word "average" because I have said this in the past and had angry emails from people saying, "I'm getting older and you're insulting me". I am not at all. The point is about "average" and participation in the labour force as people get older. Clearly, different occupations have very different profiles. The House of Lords is an outstanding example of that. But this is an important consideration in looking forward from the point of view of potential growth. Given what I said earlier about the two sources of potential growth, what is the longer-term labour supply? I am afraid that the pattern of ageing in the average population is set in the sense that it does not move quickly. It is a very long-term variable and will not move much at all.

Q7 Lord Davies of Brixton: Continuing on that theme of the employment market, it is interesting that you discussed the whole issue of the labour market without mentioning immigration, when we have a situation where, very roughly, half a million extra workers have come into the country over a relatively short period. The labour market, in terms of levels of employment and pay increases, does not seem to have been impacted at all by something which is much discussed in terms of that

impact. From what you have said, the implication is that it has had no impact at all.

Andrew Bailey: I am not sure I would quite say that. In aggregate terms, it is not as big as movements in the domestic population and domestic labour force. If you look at aggregate movements, the bigger impacts come from movements in the domestic labour force. We look at the supply side of the economy frequently. We take the immigration numbers that the ONS gives us; the OBR also gives us a view on this. We are not generating our own numbers. We are not making assumptions about what policies towards immigration will be. All I would say is that there is an economic side to that story. It is a factor to consider in the overall stance of the approach to it. But immigration on its own does not have as big an impact on labour supply as the domestic labour force.

Lord Davies of Brixton: And wages?

Andrew Bailey: Likewise, I do not think it has as big an impact as movements in the domestic labour supply.

Q8 **Baroness Liddell of Coatdyke:** Governor, I am concerned about labour market statistics. We know that there have been recent problems with the ONS. It has sought to overcome them. To what extent do quality concerns constitute a problem for the Bank in coming to conclusions on forecasts and policy? This is not a new problem. It has been around for a very long time. What can be done to fix it?

Andrew Bailey: We have expressed our concerns on this and we share your view in that sense. I would draw out two things. First, it is important that the work is done to rebuild the labour force statistics and statistics in other areas. Currently, the producer price statistics are suspended. We had an unfortunate error in the consumer prices index back in April to do with vehicle excise duty. From our point of view, it is critical that these issues are addressed.

With the Labour Force Survey, a good part of it is participation. They have increased the participation rate but it is not back to pre-Covid levels. The problem there is knowing to what extent it is a representative sample. This is critical to some of the issues we were just discussing, such as what are the trends in participation and what is causing them.

They have a plan to make further improvements. We strongly encourage that that plan is got on with and put in place. Looking at things like the CPI issue they had, and to have the quality control mechanisms in there, as I understand it, that was to do with a spreadsheet with a number in it for the vehicles that were on one particular level of fuel duty relative to others, which was wrong.

The second thing is one that I think affects all statistical authorities. There are always things going on that affect how the statistics are calculated and there is quite a lot going on at the moment, so I would pick out two. One is the so-called intangibles and how we measure them on inactivity and investment. I know that the ONS is doing work, for

instance, where it is trying to capture for the measure of GDP the value of data as a level of activity. That is valuable because we are seeing far more of it, with AI and so on, and I know that the ONS is working hard to come up with a measure of it. That is the right thing to do, because it is a reflection of the economy changing around us.

Another area that I focus on quite a lot, going back to consumer price inflation, is the so-called dynamic pricing that goes on. There is now more volatility in one part of services prices, so if you ever book a flight, a hotel room, a concert or anything now, you can find very different prices from day to day. By the way, I am not saying that the series is wrong, but there is a question about how you capture the fact that a part of it can vary rapidly from day to day. Quite rightly, it takes the sample every month on a certain day at places across the country; and how you control for these developments is another important thing to think about. That is not because things are wrong; it is how the economy is changing.

Baroness Liddell of Coatdyke: You sound frustrated by it. Are you convinced by the statistics that you are having to work with, and what country does that better than we do?

Andrew Bailey: We have been frustrated by the Labour Force Survey because, as you probably detect from everything I have said this afternoon, it is a very important part of the underlying story of monetary policy. I think many statistical agencies are facing the same issue. I still find it hard to understand why the participation rate in this country is lower. Since Covid, we just do not answer the phone—particularly when the ONS calls us up. I cannot understand why the British are any worse or different from anybody else in this respect, but that was a problem, particularly during the Covid period. It is important and our staff go over the data. As I was saying earlier, we look for a lot of alternative sources to, in a sense, validate and cross-check the data. That is the right thing to do and we will go on doing that.

Baroness Liddell of Coatdyke: Does anybody do it better than we do in the UK?

Andrew Bailey: I am not an expert on other countries' statistical agencies, to be honest, so I am not that well qualified to answer that question. I have not spent a lot of time looking at how other countries do it. There are some methodological differences and there is a lot of common ground.

One area that I have highlighted before, because it is interesting and in some ways relevant to other areas of policy, is the whole question about output in the public sector and therefore productivity which feeds through to total productivity. We saw this during Covid. The health service is the best example of it. I think the ONS would say that the UK is ahead, because it seeks to measure actual things that the health service does: procedures, operations, trips to the dentist and what have you. A lot of other countries still basically take the amount of spending, deflate it and get a total aggregate output measure.

The problem during Covid, of course, was that the stuff that it measured stopped happening. I remember Rishi Sunak, when he was Chancellor, and I asking each other, "What the hell's going on?", because health service output fell off a cliff, but it was quite clear that the NHS was absolutely totally at it. We cannot criticise them for not working hard when they were working really hard. That was a product of the way it was measured. In normal times, it may be a better way of measuring it. What we have had, though, is quite a big fall-off in productivity in the health service. If you look at productivity in the health sector relative to the end of 2019, pre-Covid, it has come down a lot. The question is what you read into that. Is it about measurement or is it about something real? I do not know.

The Chair: Baroness Wolf has a quick follow-up.

Baroness Wolf of Dulwich: Yes, I have a quick observation. In some countries, you are legally obliged to answer some surveys. That probably does not get you 100% response rates but it does get you higher ones. The more general question is about the extent to which we have become over-occupied with apparently detailed and precise survey data, which are updated constantly. If you went back 40 or 50 years, there was probably less of that. Do you have any observations about whether, on the whole, where we are now is way better than where we were 40 or 50 years ago? Might we have become overdependent on these supposedly detailed updates of supposedly highly accurate quantitative data?

Andrew Bailey: That is a really good question. I will give you one example: let us go back to unemployment. We have managed to raise interest rates from basically nothing to 5%, and disinflate the economy without having a big increase in unemployment. That is good, but if you go back to the question about inactivity then you ask, "Well, what is really going on here?" Therefore, I do not go around saying that because I am quite hesitant about it. That is an argument for saying that we need to try to use the data to understand the story as best we can.

Q9 **Lord Petitgas:** Good afternoon, Governor. My question is really about productivity again. It is clearly an issue for the whole economy and it is too low, so I have observations on two points. First, there is the disparity between what I would say are the more optimistic productivity forecasts from the OBR and those of the Bank of England, as it relates to all the decisions that you have to take. There is also the fiscal side of things for the Government. Secondly, how do you think about the methodology for the Bank of England and about its long-range productivity forecasts?

Andrew Bailey: First, the OBR should speak for itself, but I will have a go. By the way, I think I am right in saying that, just for the next two years, our growth rates and productivity are pretty similar at about 0.7% or 0.8%. You are right, though, that, looked at slightly further out, we are a bit different. I will speak carefully because it is really for the OBR to speak for itself, but I think it has a bit more of a reversion of productivity growth to its pre-financial crisis pattern than we do. The question for me

there is a really important one: what caused this falloff in productivity post financial crisis? Was it the financial crisis or something else?

If you were to take what I loosely call the OBR story, you would say it was more about the financial crisis and that that effect will wear off. I am a bit sceptical about that. There is no question that the financial crisis had a damaging effect in the short run; I am not so sure whether it has had a longer-run damaging effect. The reason is that there is a good argument that, over history, longer-term shifts in productivity are driven by technological innovation and particularly by what tends to get called general purpose technology innovation. The steam engine, electricity, the internet and ICT are the things that move the dial. If you look at the longer term, in most of the major economies post-Second World War productivity growth peaked around 1973-74 and then gradually came off. Then there was a reversion between about 1995 and 2005—the sort of internet-ICT period—but in terms of contributing to growth that has worn off.

That is a long way of saying that it is rather more about the underlying technological innovation-type drivers. If we are therefore to see a pick-up in underlying productivity growth, the question is: what is the next general purpose technology innovation? The best guess is that it is AI, in the sense that it is the most promising thing we have on the horizon at the moment.

Also, going back to the general purpose technology innovations of the past, those take quite a long time to come through into productivity data. People have said that it was about 40 years between Edison first wiring something up and electricity coming through in US productivity. It will not be that long—we are in a different world now—but they tend to take a somewhat long time. We are all essentially experimenting with AI at the moment in the expectation that we will get something from it, and I think we will. That is a long way of answering, but one way that you could describe the difference is that our story is driven more by that underlying innovation. The OBR can speak for itself but it may be saying, more than us, that the financial crisis effect will wear off.

Lord Blackwell: Governor, do you think there is anything in the argument that the scale of immigration has had an impact on productivity? Productivity is an average number. If we take in a high volume of relatively low-wage labour, the argument could be that it disincentivises investment that would otherwise drive up productivity. It also fills a number of low-wage jobs, such as delivering Amazon parcels, that did not exist before. I think the highest growth in productivity in British history followed the Black Death, when the population halved. I am not suggesting that as the remedy, but do you take account of immigration as having an impact on productivity?

Andrew Bailey: We do. I do not think we can tell you any sort of precise story on that; it would be for other parts of government to assess it. We look at the overall level, but I would not drive that story in terms of what I would call a supply of particular sorts of labour, so much as what the

demand for labour is. What do these technological innovations mean in terms of demand for labour? Amazon delivery would be a good example of that. I do not subscribe to the view that technological change destroys jobs in a mass unemployment sense. I do not think it has done that over history, but it does cause a change in the employment mix. Clearly, some jobs disappear and some are created. It creates a demand for training and investment in the skills of the labour force. I go around the country a lot and I have been to a couple of employers recently who said, "Look, we just could not get the skills we need. We've had to go abroad to find the people who have the skills to expand our business", so you do hear that.

Q10 Lord Turnbull: Can I ask you some questions about the appetite for UK debt? When Robert Stheeman retired, he gave us a very bullish account—not surprisingly, given that he had sold about £2 trillion over his career. But if we are looking forward, are there any structural changes? I think you are indicating that we are not far off or might be at a point where the Bank is neither a net buyer nor a net seller of debt. Are there any structural changes for or against the appetite for debt, given that the OBR projections have it staying quite high for quite long, and not many people bet very much that it will turn out better than that?

Andrew Bailey: That is interesting. We have seen two quite big structural changes. By the way, I do not think that UK government debt markets are unusual in this respect. The first is that there has been a change in the mix of buyers. Obviously, we are not buying and, particularly at the longer end, the LDI pension fund sector is not buying in the way that it used to. We are seeing more buying from a combination of bank treasuries, going back to the discussion we were having earlier in this session about the mix of high-quality liquid assets. We are seeing more overseas investors buying, on average, and more hedge fund activity. I will come back to that, because it is the second point I was going to make, so there is a change in the mix of buyers. Our market intelligence staff would say to me that one consequence is that we now have a mix of buyers who are probably more sensitive to relative yields in the market in their investment activity. You have a somewhat different mix of buyers in their sensitivity to yields.

The second point is particularly about hedge funds. All the major government debt markets have seen a very big change over the last decade; I made a speech on this earlier in the year. It is particularly in the primary auction market but it carries on from there. A decade ago, what I would call the bank dealers were the main buyers in that market. Today—and the gilts market is no different from the US Treasury market or other major government debt markets—the hedge funds are largely the buyers. You also have some non-bank dealers in that market now who are crossing over between those two landscapes, so the pattern of buying and activity is very different.

The point I made in the speech, which goes back to the volatility we saw in April, is that there is a lot more leverage in government debt markets now than there used to be, based on that pattern of buyers. In things

such as the basis trade, where they are trading between cash and futures markets, the profile of activity in government debt markets has changed hugely in the last decade.

Lord Turnbull: If we globalise that, lots of other Governments have projections of borrowing staying very high for very long. Is that a problem for us or is it the old story about two hunters chased by a lion? You do not have to run faster than the lion; you just have to run faster than the other guy. So long as we can stay not being an outlier, can we maintain our position?

Andrew Bailey: It is very interesting that, if you start by looking just at the UK for a moment, the pattern here since the financial crisis is that we have seen quite restrained borrowing and debt levels in both the household and business sectors. Against that there is, as you say, a different story in the government sector. We have seen a change in the pattern of overall indebtedness in the economy. I get told quite often: "You've put interest rates up from nothing to 5%. You must be very worried about the impact of that on leverage and indebtedness in the household and business sectors". I reply that I can understand why they would ask a question on that, because I would, but when you look at the actual numbers they are not at all concerning in the aggregate. By the way, there will always be people who are badly affected by it—don't get me wrong—but not in aggregate. That is quite a Ricardian outcome in terms of the balance of debt.

I do not have the figures in my head for other countries, but I am not sure whether you see the same things there. That is an interesting question. I have said to my colleagues that we need to look more into whether we see that same pattern in other countries, because there is no question that, globally, there is a shift towards sovereign debt. Part of the issue is that there are now, at least to my mind, three structural headwinds that we are facing in that world. Going back to what we said earlier, one is about the impact of an ageing population. The second is the turnaround in what tends to be called the post-Cold War defence dividend in terms of public spending. The third is what we do to adjust to climate change. If you put all three together, those are big headwinds in their demands on public indebtedness.

Lord Turnbull: You mentioned sovereign debt. Does that mean that we have more competitors for selling government debt than we used to have?

Andrew Bailey: Yes, because indebtedness numbers across the major economies are generally running higher. The US is very prominent in that sense. If you do not mind me saying, that is a really interesting question because it also gets you to the point about the dollar as a reserve currency. In many ways, I think the meaning of that term these days is that US treasuries are the safe asset in the system; there has been demand for them as a safe asset. It is a slightly chicken-and-egg question about what is driving that outcome, but it is a big shift, yes.

Lord Davies of Brixton: I have just a quick point. So hedge funds are the primary market for this debt.

Andrew Bailey: Increasingly so, yes.

Lord Davies of Brixton: They are also making a lot of money. From whom are they getting that money? Are they making it at the Government's expense or are there other counterparties out there who, for whatever reason, like to give money to hedge funds?

Andrew Bailey: That is a hard question to answer. If you look at the so-called basis trade, where they are trading very fine margins between cash and futures prices, that is where the leverage is so big. They are having to do very large trades to earn what looks like a large return in cash terms, but the margin is actually very fine. What that means is that the leverage is very big. I do not think I could really answer easily the question, because it is a good one, about the counterfactual: where would those returns go if they were not doing that? That is hard to answer. Would they go into the banking system or somewhere else? I do not know.

Lord Davies of Brixton: Someone must be paying their profits.

Andrew Bailey: You would have to compute, in a sense, the counterfactual. What would the system look like without it?

Lord Davies of Brixton: The people who are paying do not know they are paying. It is like the air that we breathe.

Andrew Bailey: I do not think any of us can say, "You know what? I can see how much I'm paying".

Q11 **Baroness Wolf of Dulwich:** I would like to ask you a question about the OBR and contextualise it a bit, first, in terms of where you started on the growing unpredictability of the environment. Secondly, there is the question that Baroness Liddell posed about the fact that our data are really not tremendously trustworthy or reliable. We have the OBR making very precise predictions and judgments, as it has to do. These feed into fiscal rules, which in turn mean that the Government suddenly jump around at the Spring Statement, so they cut something here and something there. This has some obvious defects as a system, though it may be better than the others.

I have two questions about this. First, on this system with the triangle of the OBR, the Treasury and you, how does the impact of the OBR on the Government, because of fiscal rules, in turn impact on the decisions that you are able to make? Is it a serious issue for the Bank's own decisions? Secondly, can I invite you to speculate on whether there are any ways that we can make the system slightly more acceptable and less likely to create bizarre swerves in order not to break an arbitrary rule?

Andrew Bailey: That is not our area of policy, so I will be very careful in what I say because it is really for the Treasury and the OBR.

First, we work very closely with the OBR and the Treasury. As I have said before, we condition our forecasts on announced government policies. What that means in practice is that the Government tell us what the policies are, but, even more practically, we take the OBR's important fiscal multipliers, for instance. We do not do those ourselves—we take the OBR's; so there is quite a decent OBR input in that sense. We talk to the OBR a lot and work closely with it, so we can understand its thinking behind that, but, ultimately, we take announced government policy as given. That is sensible, but I do not think it is sensible for us to come up with different views on fiscal policy in that sense.

You pose a very good question about the overall impact of this and I will be very careful in what I say.

Baroness Wolf of Dulwich: I understand.

Andrew Bailey: It is not for me to start giving judgment on fiscal policy, but I will say one thing that is exactly on the point you made. It is important to emphasise that this figure of whatever it is—currently £9 billion plus—is a five-year-ahead forecast. Now, if we know one thing about forecasts, it will not be £9 billion, but that is not a helpful thing to say. The sense would be, "Fine—thank you very much, so what number do you recommend?". All I would say is that there is a danger in overinterpreting a five-year-ahead forecast. That is not for us but for the Government, so I do not come out with recommendations on that. But I would just caution that having the financial markets marking fiscal policy to market on a daily basis is not a good state of affairs, and I do not think I am probably at odds with anybody, particularly around government, in saying that. Solving the problem is harder and there is no ready solution to it. Some people say, "If only you had a bigger number than £9 billion", but that comes at a cost and is obviously for the Chancellor. I am not prescribing any solution, but we do have to be careful about overinterpreting numbers that are inherently uncertain.

Q12 **Lord Lamont of Lerwick:** Good afternoon, Governor. When you last appeared before this committee, the subject that we asked you about quite a lot was the sustainability of the UK national debt over the longer term. The questions never change—I do not know about the answers—but perhaps you could update us on your views on that.

Andrew Bailey: Let me come back to the point I made about those three big headwinds, which are certainly running against all developed countries, if not all countries. There is the impact of an ageing population and what that means for the fiscal position—by the way, that is in terms of both the demand on public spending and ensuring the labour supply, as we discussed earlier. Sadly, there is also the question of the impact of the post-Cold War defence dividend essentially turning around now—I say sadly because I was in Ukraine on Friday, so I saw this for real. The third one is whatever the right approach is to tackling climate change, which again I leave to others to decide.

All those things are important and I am not going to prescribe what should be done about them. I do not want to sound preachy about this, but it is important that we have a proper debate with the public about the implications of all of this and what it means for the evolution of the economy and of public debt. This partly goes back to Baroness Wolf's question about not being constantly focused on the £9 billion number and saying that some very big moving parts here—this is to your question, Lord Lamont—are driving the longer-term sustainability question. Those are important and much broader public policy questions. I am afraid that they are not for us at the Bank of England, but they are broad, big public policy questions.

Lord Lamont of Lerwick: You say they are not for you at the Bank of England but you must be very concerned about it for the longer term. The OBR made not a forecast but a hypothesis on certain assumptions that, in the 2070s, debt to GDP could get to 270%, which is highly alarming for anyone to read. I know that you have made speeches about this and particularly about ageing, if I can roll this into the next question as well, but do you think that anyone is listening or that the public are paying any attention to it?

I was struck by an interview that Charles Goodhart gave. As you know, Charles Goodhart worked at the Bank of England for very many years and is highly respected, but I do not think he said anything like this when he was in the Bank. He gave an interview to the *FT* in which he said, referring to ageing, that the costs are going to be enormous. He said: "We're in for a fiscal crisis down the road and we don't know how to solve it". After he said that it was impossible to add to borrowing and that taxation was near its limit, he went on: "You know that something is unsustainable but you don't know when the dam will burst. In macroeconomics things can go on pretty much as normal, because that is what people have come to expect, and then suddenly something happens". Do you think that is an exaggeration?

Andrew Bailey: If I remember rightly, Charles made a very important point there—because I was interested to read it, too—in emphasising how important the productivity story is. If you ask, "What breaks us out of this position?", Charles's answer is that it has to be productivity. I think he is right. By the way, that is critically important because if we have a declining labour supply—or at least a labour supply that is not rising at the very least in the way that it has, because of this structural factor—the productivity story becomes even more important. This goes back to my point about what determines supply-side growth, so that is critical.

If you do not mind me saying so, the fact that this committee is doing an inquiry on this is very welcome. It is really important that all of us find a way to emphasise the importance of these questions as a matter of public policy. We are otherwise stuck in this world of managing the problems of this year and next, which we obviously have to do, rather than asking where it is all going to in the future. It is also critically important that we lay the situation out to be explained.

Q13 Lord Verjee: Good afternoon, Governor. You talked briefly about climate change and other headwinds. In early June, the *FT* wrote that “Senior Bank of England staff members who resigned from climate and nature risk supervision roles have complained the central bank neglected the issues, leaving the UK financial sector underprepared”. Can you comment on that?

Andrew Bailey: Yes, I read the article. I think the point being made—this is certainly my approach to it and I do not apologise for it—was that the Government have set us a clear remit in that respect. It is much more applicable to financial stability than it is to monetary policy in the current environment. It is not irrelevant to monetary policy but much more applicable. Climate enters into our considerations as one of the risks to financial stability, and that is how I look at it: it is a risk. There are different views, of course, around the world. The US Administration would probably take a somewhat different view. One of the views embedded in there is a point that Mark Carney made in the past on the question about the horizon: what is the horizon over which the financial stability risk crystallises and how serious is it? For me, it is one of the risks that we have to look at, but I am not going to pick it out and put it up in lights above everything else. If people criticise me for that, I am going to say, “Look, I think that is our remit in respect to financial stability”.

Lord Blackwell: Can I go back briefly to the ageing population question? This may well be a 10-year or 20-year problem and you may well think that you will not still be Governor in that time—or you may hope not to be.

Andrew Bailey: I definitely won’t be, actually.

Lord Blackwell: If we have, as the forecasts predict, an increasing proportion of the population not in the labour market but their spending power will continue to increase because, although there are poor people who are retired, there are a lot of asset-rich retirees, yet the productive capacity of the economy without productivity growth will not grow commensurately. That raises not only the question of fiscal issues. Does it not also raise that of getting into continued inflation pressures of growing spending relative to production?

Andrew Bailey: Well, it could do. One of the other arguments is the so-called lifecycle saving hypothesis: that we all save more as we get older. I know that Charles has pushed back on it, and I can understand that, but that is the argument underpinning the view that an ageing population is one of the reasons why the long-run neutral rate of interest comes down. This comes back to Lord Burns’s earlier question, because you get an increase in saving relative to investment demand, which pushes the real interest rate down. Charles does not agree with that; I think that both arguments are in play. I do not disagree with him on that particularly, but it is not a one-way argument on this point.

Lord Blackwell: I am not sure that people continue saving once they

have retired.

Andrew Bailey: I think the point is that they do not disinvest in the way that the theory would tell you. When that theory was originally developed—it goes back a long way now—there was a view that people would disinvest almost seamlessly during their retirement, but I do not think that is not actually the case.

Lord Blackwell: We can come back in 15 years to this.

Andrew Bailey: Not with me as Governor you will not, I am afraid. I say this slightly ironically, because I was giving a speech this morning at a conference we have been running on the return to the gold standard in 1925 by Montague Norman, who was Governor for 24 years, but those days are over.

Q14 **The Chair:** I will ask colleagues in a second if they have any final follow-ups in response to things you have said, but I have one myself, if I may. Going back to the first few questions in our discussion, you gave us your account of your expectations about inflation and rates. What do you think explains the stubbornness of inflation in this country, compared to the United States and the European Union? Maybe stubbornness is not the right word for it, but disinflation has certainly been weaker in underlying inflation here. What factors can you point you to explain that?

Andrew Bailey: One factor is that, going back over recent years, it looks as if we have had a tighter labour market. This comes back to the point about inactivity and exactly what the labour market position was.

Going back to 2021 particularly, I would say to people that what was hardest to read in that period was what the impact on the labour market would be of ending the furlough scheme. Almost all forecasters were expecting that to lead to an increase in unemployment and it did not, so it looks as if the labour market was much tighter coming out of that period. The UK may well have had a tighter labour market and it may be part of the story about higher levels of inactivity. We now think that we are seeing slack opening up, and that may be part of the story.

The Chair: Do any other colleagues have any final follow-up questions?

Baroness Wolf of Dulwich: This follows on directly from Lord Wood's question, because it comes back to the labour market and comparisons with other countries. I know that you cannot be an expert on every country. You discussed the labour market and the inactivity rate, but one thing which it seems we do not pay as much attention to as we should in policy discussions is not simply the tightness but the degree to which people move jobs—their job mobility. Is that something that you pay attention to?

Andrew Bailey: We do. One of the helpful things in the last month, but only in the last month, is that another part of the LFS is on flows in the labour market. That has been suspended for quite some while, so we have had no flow data. That is a problem in the exact terms of your

question. I think we now have one reading; I hope that we will get a series of them. It goes back to the overall state of the LFS as to how good those readings are, but not having the flow data—flows in and out of employment, inactivity and unemployment—has been a considerable handicap in that sense.

- Q15 **Lord Petitgas:** This is not quite a follow-up, but I cannot resist asking you a question about the general environment, the economy and the markets. What worries you the most in the whole financial system? We have had a few scares and the system has been robust and resilient. Regulation has clearly had an impact, but people are concerned about levels of leveraging and private credit in particular. Where are there, in your mind, the areas of unexploded ammunition that might come and haunt us at some point?

Andrew Bailey: There are two that are a particular focus for me at the moment. I have a rather global perspective, because I am about to take over as chair of the global Financial Stability Board—obviously, I do not have enough to do.

The first, going back to the questions from Lord Turnbull and others, is about debt markets and the build-up of leverage, particularly in the non-bank sector. A lot of our work is focused on that, not because we are saying it is bad per se, but there is a question about how it would unwind under stress, which is why we did a flow stress test last year. Are there points of pressure in the system and, if so, what do we do about it?

It was interesting that we saw some of that go on in the April period. That was not in the basis trade; it was particularly in asset swaps. We saw some transmission channels going across markets. Having said that, the system basically stood up. Obviously, I would say that, wouldn't I? My line on this whole sort of regulatory debate is that I will not pretend that our rules are perfect, but there is not a trade-off between financial stability and activity and growth in the economy. What we saw in April was a period of stress and we did not see an underlying financial stability problem. We were not dealing with banks that were failing, for instance. That is the first point.

The second is one that you mentioned. The whole private credit and private equity world has grown enormously rapidly. For me, the question there is about it still being an opaque world. I do not want to point the finger and say that there are bad things going on there. I just do not think it is currently visible enough. It is therefore going to be a focus in our work at the Bank of England but also, I hope, in the global Financial Stability Board's work. We need to lift the lid on whether there are points of pressure in there. It has grown rapidly and I think it has to have the light shone on it.

Those are two that I would pick out at the moment. If I had to name a third, it is in a completely different bit of the landscape. It would be: what are we going to see in terms of the growth of so-called stablecoins?

Particularly now that the US legislation has passed, what are they going to do?

Lord Davies of Brixton: Your second point relates to the shadow banks as well. There is that whole financial structure that is really outside your purview, in many ways.

Andrew Bailey: You may well have better figures than me, but I think I am right in saying—if I am wrong, I will write to you to correct it—that firms owned by the private credit and private equity world employ around 2 million people in this country, so it is not small. I am not saying that that is wrong at all, but it is less visible.

Lord Burns: This is a small issue, but I noticed, reading the minutes, that you have a lovely spreadsheet at the bottom of them. There is a link that shows the voting patterns on the MPC, going back more or less to the beginning.

Andrew Bailey: The beginning of time.

Lord Burns: It just happened that I had five minutes to spare and I was looking down that. I would have said, on the face of it, that the number of minority votes is extremely small, considering the degree of uncertainty that there is in this world. As we have been saying, extraordinary things can happen. Is it the sort of number that you would have expected, or is it higher or lower? It gets a lot of attention whenever—

Andrew Bailey: It does, yes, more than in other monetary policy bodies, I should say.

Lord Burns: What happens on other monetary policy bodies, sorry?

Andrew Bailey: It is more than in other monetary policy bodies. I know that we have had a discussion in previous years about groupthink. My approach is that it is important that the essence of the way our system works is that the nine of us get in a room and we deliberate at some length, as you know—you have been there. Then we reach a view. I want my colleagues to feel that they vote on their view, but we have to have an outcome, and we do. I am very robust on this: I really do not think that there is groupthink in the committee. I get the opposite pushback from different people who say, “You people just get together and you come up with a single answer”, so this argument goes both ways, frankly. What we are seeing at the moment is a genuine expression of the views of people on the committee. As I described earlier, I welcome the fact that there are different views. I want different views on the committee and for people to feel that they can express them—and that you can see that they have done that.

Lord Verjee: I think I am right that we have not mentioned China in this whole session.

Andrew Bailey: No, you have not.

Lord Verjee: Can you comment a little on long-term debt sustainability within a really changing geopolitical world? We have Middle East countries that used to be net lenders and are now net borrowers; we have China having to take a really deep geopolitical view. How much impact is that going to have on our debt sustainability in the future?

Andrew Bailey: There is a very big and important current question underpinning that about long-term imbalances in the world economy. There will of course be such imbalances; that is the way that development happens and it is important. Of course, the question is one that the US Administration have put firmly on the table: is that an unsustainable position, in terms of China in particular? They also have views on other parts of the world, but particularly on China. My own view is that these imbalances are driven predominantly by macroeconomic outcomes. There is a level below, which you might call the more transactional trade element—the stuff that the WTO is responsible for. That has an effect, but the underlying macroeconomic conditions are far more the dominant factor.

China has had weak household domestic demand for a long time, which in a sense has supported an investment-heavy, export-heavy development model. What I think—I will be saying more on this when I have written it—is that we cannot have a situation where the multilateral institutional system decays, so we have to get back to tackling these questions in a multilateral setting. The history of that is not easy at all, if you go back in time, but I do not think that unilateral tariff action is a sustainable solution to this. We have to have much more of a multilateral understanding. My experience, when I put it to the Chinese, as I have done, “You do have an issue with domestic household demand”, is that they do not disagree. However, I do not think it is so clear what the action is.

The Chair: We will have one last question from Lord Lamont.

Q16 **Lord Lamont of Lerwick:** I wonder if I could go back to Lord Verjee’s previous question about green policies and the policies of Mr Carney, which I was interested to read that he is reversing in Canada entirely.

Andrew Bailey: I do not want to comment on Canadian politics, please.

Lord Lamont of Lerwick: No, that is not for us. The Government have modified their policy slightly towards North Sea oil and gas, with their decisions on Rosebank and Jackdaw. None the less, it was stated in a paper on Sunday that no UK bank will lend to the North Sea sector today. Is that right and would you not be profoundly unhappy if that were true?

Andrew Bailey: Well, I do not know, to be honest. That is an issue for the Government to take up with the banks. Whatever you think about the climate issue, the transition period to net zero is quite a long one. It requires having what you might call a sustainable base-energy supply level. The question of what investment is needed to support that naturally follows; I think you are right on that. Frankly, if there is an

issue with banks lending, I would encourage the Government to talk to them and say what they want to see. I do not think we should be making that policy ourselves; it is for the Government to decide. I read very much the same thing about defence companies and would say the same thing. It is for the Government to give a steer to the banks and say, "Look, this is a big public policy issue and this is what we think should be going on".

The Chair: Governor, thank you so much. We have taken you across the world and the policy spectrum.

Andrew Bailey: You are welcome.

The Chair: You have been very full in your answers and we really appreciate your time and candour. You made one rash forecast today in saying that you will not be Governor in 25 years.

Andrew Bailey: I think that is in the legislation.

The Chair: I will hold you to that. Thank you very much and with that, I declare this meeting closed.