House of Commons

Treasury Committee

Oral evidence: Bank of England Financial Stability Reports, HC 674

Tuesday 22 July 2025

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Watch the meeting

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

Questions 68-133

Witnesses

I: Andrew Bailey, Governor, Bank of England; Professor Randall Kroszner, External Member, Financial Policy Committee, Bank of England; and Carolyn Wilkins, External Member, Financial Policy Committee, Bank of England.

Written evidence from witnesses:

– [Add names of witnesses and hyperlink to submissions]

Examination of witnesses

Witnesses: Andrew Bailey, Professor Randall Kroszner and Carolyn Wilkins.

Q68 **Chair:** Welcome to the Treasury Committee on Tuesday 22 July 2025. We are pleased to have before us today the Governor of the Bank of England, Andrew Bailey, who is joined by two external members of the Financial Policy Committee, Professor Randall Kroszner and Carolyn Wilkins. We are here to talk about the Bank of England's financial stability report, which came out this month.

Governor, do you have any concerns generally about financial stability? In particular, what is your concern about the cost of borrowing at the moment? It is obviously going up; how do you think that is affecting financial stability?

Andrew Bailey: You are probably referring to movements in bond yields, particularly over the course of this year. The first thing I would say is that we have seen an increase in term premia in Government bond markets, by which I mean that yield curves have steepened, so the cost of longer-term borrowing has increased. It has not really increased at the short end, because that is pinned down and determined by monetary policy, but we have seen the steepening of yield curves. The important thing to say is that that is a global phenomenon; it is not in any sense unique to this country.

In fact, the pattern in this country is not in any sense out of line with what we have seen in other markets, and we have seen steeper increases in some other markets. What are the causes of that? In the short run, I think it is greater uncertainty on two fronts, really. One is obviously the uncertainty around exactly what is going on in trade policy at the moment, and the uncertainty that is created.

The second thing is the uncertainty globally around fiscal policy. That is, again, a global phenomenon. If you put that into a somewhat longer-term context—looking over the last decade, for instance—one of the big shifts we have seen in the landscape has been a shift in many countries, and it is true of this country, towards greater Government borrowing, but on the other side of the balance sheet, if you like, in terms of the private sector, by which I mean both households and corporates, the increase in debt levels has been much more subdued. We have seen this shift in the balance of borrowing. That is a reflection of challenges in fiscal policy and deliberate directions in fiscal policy, and I think that uncertainty around the direction of fiscal policy is having some effect on term premia in bond markets. Again, it is a global phenomenon, though.

Q69 **Chair:** You sound unconcerned. Is that a fair characterisation? Or is it just that the Governor of the Bank of England always has to be unconcerned?

Andrew Bailey: I am not unconcerned. It is reflective of conditions. Those two conditions are much greater uncertainty around geopolitics and trade policy, and the general trend and pressure on fiscal policy in many countries.

Q70 **Chair:** We could talk about that a lot more, but I want to turn to Professor Kroszner and Carolyn Wilkins, as external members of the committee. We have had a lot of discussion about regulatory change, and the Chancellor made those points again at the Mansion House speech with her Leeds reforms. Do you have any red lines, as individuals and members of the committee, on regulatory change?

Professor Kroszner: It is certainly very important to make sure that we maintain resilience in the financial system. That is fundamental: it is the key remit and prime goal of the Financial Policy Committee. Certainly, at least from my perspective—I cannot speak for others—anything that would challenge the resilience of the financial system would be a red line. But I do not have any particulars for you—

Chair: No concrete examples?

Professor Kroszner: No concrete examples, but certainly that is our remit and that is what we need to do. It is extremely important that we continue to to maintain financial stability, because that is fundamental to economic growth, as we saw during the global financial crisis. If you do not have financial stability, it will be a major challenge to have economic growth.

Chair: Indeed. What about you, Ms Wilkins?

Carolyn Wilkins: I share the same support for the financial stability mandate and, at the same time, I realise that a lot of the reforms that we did post the GFC have stood us in very good stead. We have seen that given the stresses that the banking system, not only in the UK but elsewhere, has come under over the past few years. At the same time, we also know, with all humility, that it is not perfect and there are ways that we can look at the regulations and maybe simplify or alter them in some way and still achieve a very good financial stability outcome with more efficiency. Part of our work that we are focused on is exactly how to do that specifically in a way that really serves the growth agenda.

Q71 **Chair:** Could you talk us through how you, as a committee, monitor that change? You mentioned the changes after the financial crisis, and although, as you say, nothing is ever perfect, in monitoring that overall change and the impact of regulatory reform on stability, what are you looking at when you are in committee, or preparing for it, to make that judgment? Your experience in Canada is probably quite relevant here.

Carolyn Wilkins: It depends on what aspect of regulation you are looking at. I can give you a couple of examples quickly.

One recent and relevant example is the changes we made to the affordability guidance that we had given with respect to the add-on to the interest rates. That was so people could afford it, and their debt-service ratio would not be too high if interest rates increased by, say, 300 basis points relative to the contractual reference rate. At the same, we have a loan-to-income flow limit of 15%.

The question was: "After a few years, can we do some analytical research to see where they are binding and whether they are both needed?" Because we had the data and experience, as you know well, we realised that in fact we did not need them both. We thought we could achieve the same financial stability outcome with the FCA's own affordability limit, so we made changes there. We did the same with another change with the LTI in the last FSR—in the last committee meeting.

On the capital side, there are stress tests, which are checks on the levels of capital—the buffers that are there. There are different mechanisms. Having been at the Bank of Canada, and having looked at other central banks, the Bank of England is quite good at its modelling and is really ambitious in its data collection to take this kind of analytics seriously.

Chair: Okay, so you are really leaning into the data and analytics very heavily. Professor Kroszner, do you have anything to add?

Professor Kroszner: That is exactly right. One of the things that was attractive to me, when I was very honoured to be asked to be considered to be part of the committee, is that the Bank of England takes cost-benefit very seriously. We dive into the data, do the analytics and try to think about the best way to achieve the outcome. Of course, as Carolyn said, that is never perfect, but we try to reassess, just like we did with the mortgage affordability issues, put out a rule, gather the data, and assess whether there is a more effective way to assure that we get the goal that we want at the least cost.

Q72 **Chair:** Obviously, when the Chancellor made her Mansion House speech she leaned into the previous pledges she made, now called the Leeds reforms. Are there any elements of those reforms that will not worry you and make you nervous in terms of financial stability? If so, how are you pushing back or making judgments about how to implement them?

Professor Kroszner: A lot of different issues have arisen. We basically use the same focus that I mentioned before: we look at the costs and benefits. We take the financial stability remit very seriously, and at least so far, with the way they have been proposed in a general sense, I do not see a necessary clash between financial stability and some of those reforms. But the devil is always in the details. Exactly how do you do it? If you reform capital or liquidity, those can be reasonable reforms or they can face a lot of challenges.

One of the biggest challenges we have is that in the post-crisis period, a lot of activities have moved outside the traditional banking sector. That is both an intended and unintended consequence of the post-crisis reforms. You wanted some risky things not to be done by banks, but just because the banks are not doing it does not mean that no one is doing it. That is one of the reasons why the committee has really focused on the non-bank sector, to make sure that you are not just getting a migration of risk to an area that is less transparent.

Carolyn Wilkins: I would have said something very similar to that. To save time, I will just add that aside from the non-bank financial sector, the other areas that I think are really important for innovation and growth are new areas like AI and stablecoins. These are other forms of digitalisation where hard choices need to be made about our risk appetite, about where the risks to financial stability actually lie, and about how we get our arms around that and have the right safeguards, while at the same time not inordinately getting in the way of what might be a productive innovation.

Q73 **John Grady:** Professor Kroszner, you mentioned the non-bank financial sector, and that features prominently in the report. Are you confident that the Bank has got the right tools to get information on what is going on in that sector? Are you confident that at the moment it is adequately regulated from a stability point of view?

Professor Kroszner: One of the things the Financial Policy Committee has done is the so-called SWES. I had been at the US Federal Reserve, and I did not think that any institution could possibly have more acronyms, but the Bank of England makes the Fed look simple on that front. The SWES was to try to look at exactly this sector—it was the first work that had been done to try to look systematically at the non-bank sector. We are still learning, so I do not have a final answer for you yet on what other tools we might need, but it was a valuable first step that a lot of other countries are now following. I gave my first speech as a FPC member on exactly this issue—saying the US should be doing something like this—and they are starting to explore these issues.

Andrew Bailey: You make a very interesting point about access to information. To pick up the point Randy made about the system-wide exercise, we were able to do that because we have a very large concentration of the financial services industry in this country. We were able to go to the firms, and the firms were actually pretty keen to sign up to this exercise. We did it in a hub and spokes arrangement, where we were the hub and they were the spokes, and they provided us with their information. That was very helpful to us, and allowed us to do a comprehensive exercise, which is a world-leading exercise.

Globally, we are not yet in as good a position on this front, and that is important. To put my other hat on for a moment, which is as chair of the global Financial Stability Board, we are currently doing work in that forum to seek to improve the access to data globally. We do not have the same consistent access to data that we were able to get in this country as the Bank of England. That is a matter of some concern.

Q74 **John Grady:** I have a potentially stupid follow-up question. Following the financial crisis, we introduced EMIR and MiFID, and instruments like that, which target information gathering for monitoring—that is one of the key policy purposes. Is that where we need to look at updating global regulation, so that you can get more information from different institutions and different types of institutions?

Andrew Bailey: It can be. There are two parts to it: one is access to the information and the other is sharing it. You have situations where there is national access to information, but there are not gateways to share it internationally. This is a particular issue when you are talking about the non-bank world.

Let us take the hedge-fund world as the most obvious case point—it is also the biggest case point. By their very nature, they are cross-border institutions—they are global institutions by the nature of what they do—so access to global information is very important. We have a slightly privileged ability to get access in the UK because we have such a large concentration of the industry here, and so we can go to them. But we need better global information on that front to complete the picture, so it is important.

Q75 **Lola McEvoy:** I want to pick up on Professor Kroszner's expertise and talk a bit about the markets and equities at the moment. US and global equities have bounced back from the initial tariff shock. What is your read on why that has happened?

Professor Kroszner: It is always very difficult to assess the market movements, but I will take a stab at it. As economists say, there is a wide standard error in trying to explain market movements. I think there was a shock because people were not expecting the kind of tariff proposals that the President came up with. Even though President Trump had talked about imposing tariffs, people did not know what that would look like, and I think they were quite surprised at the extent of them—both the level and the breadth.

Obviously, what has happened over time is that the President has proposed pushing back the date for when the tariffs will be implemented, giving more flexibility for negotiation. That was very helpful for the market to come back.

Some other things have also happened in the US. The President's Bill relating to the budget and taxation was passed, and that has a significant extension of previous cuts to taxes on investment. That has been very helpful in maintaining investment in the US. My colleagues at the University of Chicago and others did work on the initial Trump tax plan from the previous Administration, and found that the initial expensing of investment was very powerful in giving incentives for investment. The new Bill makes that permanent and reduces the uncertainty around it.

It is a combination of some of the reduction of uncertainty related to the taxing of investment, and the greater clarity around the tariff proposals, which has helped the markets to feel more confident. Also, the US economy has continued to be resilient: the labour market and consumption have remained fairly robust. Even despite some significant initial drops in consumer confidence, the actual spending numbers have reasonably been solid.

Andrew Bailey: Can I add one point? This is very important, because there are two things going on here that sit somewhat in tension. One is, as Randy said, the reaction to all the news on tariffs. The fact that equity risk premia have gone back to where they were before that news came out is a vulnerability. It must be clear that that looks like a very compressed risk position.

On the other hand, there is this other story—which, as I say, Randy was referring to—which is essentially that, particularly in the US, it is a very strong tech-led growth story. Here is a striking fact: the market capitalisation of Nvidia is now larger than the UK's GDP. It is up 20% this year. That is a pretty striking fact. It is 7% of the overall market capitalisation in the US. You have these two big stories running alongside each other, and in some ways in a bit of tension with each other at the moment.

Q76 **Lola McEvoy:** In your speech, you mentioned the global threats as the big concern for stability in the UK. How do you think falling back to the pre-April, pre-tariff equities is going to impact us?

Andrew Bailey: To develop that, in terms of markets, one of the other big things that has happened is that we have had a breakdown in what I would call established correlations in markets. That is another area where we can be quite heavily affected. What do I mean by that? Prior to all this starting, for some time you had a pretty established relationship—I am talking about the correlation between bond yields, equity markets and the dollar exchange rate. What we have seen since April is that those correlations have essentially broken down somewhat.

The one that has particularly broken down is the dollar exchange rate: the dollar has depreciated. As we were just discussing, at the same time as we have had this story about equity risk premia going back to where they were, the dollar has continued to depreciate. There are two things going on behind that. One is that, over time, longer-term investors, who are typically overweight dollar assets, are looking again at that and saying, "We probably don't want to be so overweight as we were." This will take quite a while, because these are longer-term investors, so it takes longer to work its way through the system. We sense, and we are told by the markets, that there is rebalancing going on, which involves a reduction in exposure to dollar assets over time.

The second thing going on is that they are also typically unhedged on their dollar positions, because over time it would have been a pretty good trade because of the growth story that I was talking about a few minutes ago. The message we now get very clearly is that there is hedging of dollar positions going on, to essentially hedge against what we are now seeing as the decline in the dollar exchange rate. The most crowded trade in the market at the moment is short dollars. That is, of course, important because 90% of FX trades have dollars on one side of them. Again, in terms of impact on the UK, that is the thing that we have to watch very carefully, because this is a major change in market correlations.

Q77 **Lola McEvoy:** On the recalibration, do you think we are finding ourselves in a new normal? How long is that likely to take? You said it is going to take quite a long time to get to a position of stability after the changes.

Andrew Bailey: I think we will be in this for some time, for two reasons. One is because, as I said, longer-term investors move more slowly because their positions move more slowly. Secondly, of course, it does depend on how the whole trade and tariff story plays out. We are not through it yet. We do not know much for certain, but that is probably one thing we do know for certain.

Q78 **Dame Harriett Baldwin:** Governor, I am interested in the Financial Stability Board's view on the latest ringfencing review. The previous Government did one under Sir Keith Skeoch and there were some changes, and now the Chancellor has announced that, as part of the Leeds reforms, there is going to be a further review of ringfencing. Clearly, the banks have persuaded the Chancellor and the Economic Secretary that that is needed. You have come out very strongly in favour of the current ringfencing regime; is that the view of the whole committee?

Andrew Bailey: I will start with a general point, because I think it applies very well to this case, and it picks up things that Randy and Carolyn said earlier. There is not a trade-off between financial stability and growth in the economy in a fundamental sense, but does that mean that every one of our rules and every one of the details is perfectly formed? No, it certainly does not.

I was very supportive of Keith Skeoch's work. I thought he went into the detail of it. As you may remember, Parliament legislated the ringfence down to a very great level of detail—that is obviously what you can do. Were all of those details, frankly, once it got put into practice, the best way to do it? No, I think Keith Skeoch pointed to some sensible things. The Government want to have a further review. I have not discussed it yet particularly with the Government.

Q79 **Dame Harriett Baldwin:** What are the committee's red lines?

Andrew Bailey: As you have said I said, and I have said and will say again, I do think that the ringfencing regime is an important part of the structure of the banking system. I will give you one big reason why: it makes the resolution of banks if they get into trouble much easier, and it benefits particularly in terms of UK customers and UK consumers—businesses and households. I think that is a helpful feature of it.

I do not think it hinders banks fundamentally in terms of their business models. But, again, at the margins, I am sure there are things that can be improved, and we will work constructively to get through that process.

Dame Harriett Baldwin: It sounds as though the view of your committee is that you want it to remain in place with some tweaks.

Andrew Bailey: It has established itself as part of the system and for me it would not be sensible to take it away at this point.

Q80 **Dame Harriett Baldwin:** Professor Kroszner, do you have a red line in this area?

Professor Kroszner: No. Once again, there are no particular red lines. What we do is to look at the different cost-benefits of different changes to try to see how we can achieve the resilience goals at the least cost. I think that is exactly what the Chancellor is trying to raise in the proposed reforms—how do we maintain stability at the least cost possible?

Q81 **Dame Harriett Baldwin:** Professor Wilkins, do you have a view that it should remain in place?

Carolyn Wilkins: For the reasons that were mentioned, it works well. Given that the UK financial system is an international centre for financial institutions, to have institutions that are concentrated on the UK economy is very helpful for growth and for stability.

When we think about the trade-offs between stability and growth, I do not think they are as big as people imagine they are. In particular, the UK relies, quite happily I think, on a lot of foreign direct investment for a lot of investment in this country. Part of the reason why is because there is faith and trust that the regulatory system is going to do its job. Accidents like those that happened in 2008 or 2009 really undermine that trust, and investment can go elsewhere. Having the system in place, in terms of international peers, has really reinforced confidence in the UK financial system.

Q82 **Chair:** Governor, you and the committee have wide-ranging powers in terms of making recommendations, including to the Treasury. Would you be prepared to use those powers if you think the Treasury is going too far in its deregulatory objectives?

Andrew Bailey: I think we would certainly start by making our views very clear, and we would make them clear in public, and we would obviously make them clear to this Committee, if you would wish us to do that. We will start there, I would think.

Q83 **Chair:** We have talked about red lines a lot today. Do you have any red lines on deregulation? The Chancellor again leant into it last week at the Mansion House. She expressed a lot of quite strong views about where risk should lie and said that we are risk-averse in this country so we should deregulate for that. Where are your views?

Andrew Bailey: I have two very strong red lines of principle. One is that, as I just said a few minutes ago, there is not a trade-off between financial stability and growth—we have had that experience—and the second one comes out of that.

Sadly, I can understand when I hear people say, "The financial crisis is now way in the past. We've got past that. That is all solved. That is out of the way. Move on." I suppose that for those of us who are veterans of sorting out the problems of that—I think all three of us in some ways were, in different parts of the world—no. Yes, of course the world moves on, but that was the experience of losing financial stability and we had a very serious recession in this country after that. I am afraid that I do react to people who say those things, because I say, "Sorry, this is the fundamental point about why financial stability is important."

The final point I am making, which goes back to one of the earlier questions, is that, of course, success in financial stability is when nothing happens. The fact that we have had market volatility this year and we have not had a financial stability problem—we are not worrying about banks failing, we are not worrying about markets—is, of course, a success. It is not always easy to point to it and say, "Look, this is good news," but as we have pointed to, the UK banking system is very resilient, in our view.

Q84 **Chair:** With all these changes—we have had it repeatedly from Ministers—it could make things riskier, though. We have to challenge the Government on that. Will it mean that consumers are more at risk?

Andrew Bailey: The second part of my overall comment is, as I said before: are all of our rules perfectly formed? No, they are not. By the way, there is a Brexit point here—I am always careful to say that I do not take sides on Brexit, and I do not—because we inherited quite a lot of our rulebook we inherited from the European Union, having been a member of the European Union. Of course, European Union rules are made for the European Union as a whole, so you get an average in treatment; you do not get something that always precisely fits your market. This gives us an opportunity to look at that rulebook and say, "How do we, in a sense, make it a better fit for the UK?" That is a very sensible thing to do. It does not compromise us on financial stability, in that sense.

Q85 **Chair:** The Chancellor has been very trenchant. She talks about regulations being the "boot on the neck" of financial services firms. Do you agree with that?

Andrew Bailey: Well, I don't use those terms; let me say that.

Chair: What language would you use if you were to respond to that?

Andrew Bailey: It is not a term I use.

Q86 **Chair:** Do you think that there is a problem with the over-regulation of financial services firms?

Andrew Bailey: Look, there are areas where we clearly should look at it, for the reasons I have just given, and we will look at it; we are very open to that. We have announced a whole range of things we are doing, and that is a good thing. But we cannot compromise on basic financial stability—that would be my overall message.

Q87 **Chair:** We have an international panel here, and you chair an international body on financial stability. The Chancellor has also said that the UK—she blames the bureaucracy—has a "culture of risk aversion, to the point of obsession with stamping risk out in all its forms," which "is not an approach seen in any of our competitors." Do you agree with that?

Andrew Bailey: I would say this. Quite a bit, of course, of the core financial services regulation is international. Basel, of course, is global. As I just said, quite a bit of our rulebook across quite a large part of the bank and non-bank world is inherited from the EU. So it is not unique to us, in that sense.

Q88 **Chair:** Given the role of financial services in our economy and the size of it in the UK, do you think we have to play a different role? We are now between the US and Europe. There are options there, despite the international rules that will apply. We have potentially an opportunity, but also potentially a risk.

Andrew Bailey: There are two things I would say about that. A comment that the IMF made some years ago about the UK, and it is right, is that the UK's financial sector is a global public good—in the sense it's very big. We are a very big financial sector, and that is a good thing, obviously. I am not for a moment suggesting it is otherwise, but it does give us a responsibility globally, because of that. Does it make us, in a sense, a player in the middle? Well, it makes us an important player. That is why I am very honoured to be chairing the Financial Stability Board. It gives us a larger role in that, and we take it very seriously. But the configurations in those debates can vary sometimes. It is not that predictable.

Chair: Thank you for that.

Q89 **Dame Harriett Baldwin:** I want to move on to the implications of stablecoins for financial stability, but first I want to talk about the Bank's own project, the central bank digital currency—the Britcoin. You have spent millions developing this so far, and yet you have said publicly that you remain to be convinced of the benefits, Governor. Are you likely to make a go or no-go decision on this central bank digital currency for the UK? Other central banks seem to be going in that direction; the US is very clearly not. I wondered where your views were.

Andrew Bailey: I think the ECB is the central bank that has so far been—

Dame Harriett Baldwin: China?

Andrew Bailey: China has done it. The ECB are more committed to it than most others, I would say.

Dame Harriett Baldwin: What are we going to do here in the UK?

Andrew Bailey: I will say two things on that. First, on the spending, if you don't mind me saying so, we have spent money so far on investigating largely the technology. I am very pleased we have done that, because the important issue here, as I have said a number of times in public, is how we get the benefits of digital technology in the payments system. I think there are huge benefits in terms of smart contracts, reducing fraud, reducing cost and improving late payments for small firms through smarter payments technology, which I think could be a real benefit. Spending money on the technology will pay off, whichever route we go down, so that is not a regret spend.

Q90 **Dame Harriett Baldwin:** But when are you going to decide? There must be a point where you make a go or no-go decision.

Andrew Bailey: Let me come to that. To simplify it for a moment, the question for me is how do we best get digital technology into the payments system? There are broadly three ways you can do it, which are not exclusive. You can do it through commercial bank accounts' payment systems, because most of our money is in commercial banks—it is commercial bank money. We can introduce a retail central bank digital currency. Wholesale is a different matter; we are doing that. And we can see the growth of stablecoins, which is non-bank money, if you like. My view is that we need to make sure that we get this benefit through one. You were at the Mansion House; I think you saw what I announced last week. We are going to work with the banks in the UK and with the market to develop, frankly, digital technology in the commercial bank payment systems—in the main payment systems of this country, particularly the faster ones. I think that is a sensible place to do it because that is where most of our money is. My view is, if that is a success, I question why we need to introduce a new form of money now.

Dame Harriett Baldwin: So you are not going to do it, are you? That is what I am hearing.

Andrew Bailey: Well, we are not saying no. I am saying that if the work with the commercial banks is successful, I would need a lot of convincing that the use case was made.

Q91 **Dame Harriett Baldwin:** That is really helpful. Now I am going to turn to Professor Kroszner. In the US they have this week gone down this route and practically everyone in the US seems to be issuing their own coin at the moment. What implications does that have for financial stability for us here in the UK?

Professor Kroszner: I would like it to be on the record that I am not planning to issue a coin.

Dame Harriett Baldwin: You are probably the only one.

Professor Kroszner: One of the very few.

It is very important that we finally have a clear regime in the US, because that was creating an enormous amount of uncertainty. Things were happening offshore, and to just have activity offshore is not good for financial stability. You want to have a good regime where people will actually use the regime. It has to be very clear and also has to allow for commercial viability of the institutions. The key provisions of the GENIUS Act are that the stablecoin issuers will not have access to Federal Reserve master accounts or the Federal Reserve discount window. They will not have deposit insurance, but they will be able to hold high quality liquid assets, primarily short-term US Treasury securities, so they will get remuneration on their assets. They will have relatively limited interest rate risk and effectively no credit risk.

Q92 **Dame Harriett Baldwin:** This has the potential to disintermediate a lot of the US banking system and potentially have an impact here in the UK as well.

Professor Kroszner: It has the potential in the US. What is interesting in the US is that some US banks have become interested in potentially issuing stablecoins themselves. But you are exactly right. If there is an alternative to bank deposits that is more attractive for people, that could lead to money flowing out of traditional deposits into that area. I think the banks are well aware of that. I think their voices were heard in the formation of the GENIUS Act, and I think they are comfortable that they will be able to manage this. But it is for you, as we consider the stablecoin regime here in the UK, to ensure that it continues to provide stability. It can be a good source of innovation and potentially reduce costs, particularly for international transactions, but we do not want that to come at the cost of financial instability.

Q93 **Dame Harriett Baldwin:** I am old enough to remember when money market funds that had a dollar as the guaranteed price collapsed during the financial crisis. Stablecoins seem to me to have the potential to create a big run on the underlying assets.

Professor Kroszner: It is extremely important to try to think about the runs on them. That is one of the reasons why, at least in the US, the law now is that you have to hold short-term Treasury securities. You cannot be holding Lehman Brothers paper, for example, because it was the reserve fund that was holding Lehman Brothers paper—the fund that so-called broke the buck because they were holding a company that obviously got into a great deal of trouble, and the net asset value fell sufficiently below the 1:1 that they had to break the buck. This is the approach that the US has taken to have that.

Of course, you have to have very careful monitoring and disclosure around that because you could say, yes, you are supposed to do that; but unless it is actually enforced carefully, you have to be very wary of that. The GENIUS Act has, I think, a fairly robust reporting and auditing regime; that is part of it. But it is true that if you do not have confidence in the underlying asset that is behind this, and that there are sufficient assets there, it is subject to run risk.

Q94 **Dame Harriett Baldwin:** So, Governor, stablecoins increase the risk of financial instability.

Andrew Bailey: The key issue—Randy is absolutely right—is that stablecoins purport to be money. The key feature of money here is that they have assured nominal value. Because if I am going to use them to pay money to you, you want to know that the pound you get from me is the same as the pound you have. This is the whole point about the assurance of the value of money. That is the test they are going to have to meet to satisfy this, and that is the test we are going to have to hold them to because, as you say, money market funds did not meet that test.

Q95 **Dame Harriett Baldwin:** Do they have the potential to increase financial instability, Governor?

Andrew Bailey: If they do not meet that test, or if they were purported to meet that test and then failed to meet it, then the answer is yes.

Dame Harriett Baldwin: As we saw recently, the gilt market itself does not have perfect liquidity, either. You are nodding your head vigorously, Ms Wilkins.

Carolyn Wilkins: Yes. I feel really strongly about this, because if it is a systemically important stablecoin, so it is the backbone of payments in the UK or anywhere, it has to be able to hold its value. It is not just about the backing assets; it is about the capital it holds, and the liquidity that it holds for operational issues, for short-term liquidity needs; and it is about consumer protection, fraud, AML and all that kind of stuff.

The challenge for the UK, which we are working through, is how to have a regime that is safe, and provides all those protections so it serves the UK well, but at the same time is compatible enough with the US and EU regimes. You must have a business model that is viable in some sense, but safe. That is the work we are doing. We got lots of useful comments on the discussion paper that was put out. We are thinking those through and there are going to be a lot of interesting discussions coming up on that.

It sounds like I am really negative on stablecoins; I am not. I just feel that, if we are going to have the potential, particularly in cross-border payments or even just in retail payments, they have to be properly regulated.

Q96 **Dame Harriett Baldwin:** I have a simple question for all three of you—a yes/no answer, please. You are the Financial Stability Board. We put our trust in you, keeping things stable. Do stablecoins make the financial markets more stable or less stable—yes or no? Do they make them less stable, Ms Wilkins? Just a yes or no.

Carolyn Wilkins: As they are regulated now?

Dame Harriett Baldwin: Just a yes or no.

Andrew Bailey: Well, they can do.

Carolyn Wilkins: They can do, yes. That is the point. But without regulation, no.

Andrew Bailey: The key thing is that one of the big reasons we regulate banks and the banking system is the value of money—it is this assurance over the value of money. A pound in my bank account is assured to be the same as a pound in your bank account, and they are going to have to meet that test. If they do, the answer to your question is yes; if they do not, the answer to your question is no.[1]

Professor Kroszner: Exactly; I would agree. It really depends on the regulatory structure. That is true of money market funds, and it is true of deposit accounts at banks. It really depends on the appropriate regulatory structure.

Dame Harriett Baldwin: I am sure it is a subject we will come back to.

Q97 **Lola McEvoy:** Governor, we have just heard that the fact that we haven't had a massive recession as a result of the global instability is a success story for the country, but in Darlington people are still struggling with the cost of living and things feel pretty tough out there, in all our constituencies, for ordinary working people. In terms of the changes to mortgages, we have seen that individual lenders will be able to exceed the existing limit on loan-to-income ratios. I am just wondering, is this the biggest tool we have got to make sure that ordinary people can get a foot on the ladder in terms of buying houses, or is it a very small change?

Andrew Bailey: Well, it is important. It is the thing that we can do. I would qualify it by saying that when we ask people, particularly first-time buyers, what the impediments are, the answer that scores largest in that question is access to the deposit, not the cost of servicing the debt. We only have this tool; we do not have the tool to address that question. That is an important caveat: the question of access to the deposit is not addressed by us changing the way in which we configure the LTI scheme.

We set the 15% limit a decade ago as an aggregate limit because it is a macro policy. It was designed to say that there is a certain level in the economy as a whole above which, looking in the past, LTI has contributed to economic instability. We have actually never seen the full 15% used because it is a macro policy and when it is applied at the micro level, firm by firm, they do not all use it. Currently the level is about 9.7%, rather than 15%. We have made a few changes over the years. I think this one really has the potential to push that number up, but I come back to my caveat. The question of access to the deposit will, of course, still be very important for first-time buyers.

Q98 **Lola McEvoy:** If people are using two thirds of the 15% aggregate limit, is it enough of a change to be felt by constituents in Darlington? What I am trying to get at is, when we were looking into it, it sounded fantastic that more people were going to have access to mortgages, but when we looked into the detail, it seemed like such a tiny change—that each firm is going to be responsible for their own individual increases, and they only have a risk appetite of 9.7%, not even 14%. What is your read on how this will actually shift the market?

[1] The Governor clarified after the hearing that if stablecoins do not meet that test, then they would have the potential to reduce financial stability.

Andrew Bailey: We have had large lenders come to us and say that if we were to raise the application of this 15% at the individual level, they would do quite a bit more. We have already had two applications in the last week, because we have changed it immediately—I expect more, by the way. I do think it will make a difference, but there are quite a lot of lenders whose business models are not to be large in this market. They are not focused on the high-LTI end of the market. They are not going to change, because that is their business model, so I do not expect every firm to come along to us and say, "We're going for it", but I do think it will make a difference.

Q99 **Lola McEvoy:** Ms Wilkins, you mentioned these changes in your opening remarks. What do you think the material impact will be, and how quickly—the Governor has just said that two firms have already applied—do you think we will see changes on the ground?

Carolyn Wilkins: That is going to be up to the PRA and how it implements it, but we have been told exactly what you just heard: it is effective immediately and there is appetite. The PRA can approve those numbers, but then it is up to the financial institutions to extend the mortgages, and I do not know about their timing. Certainly, when you look at the data, first-time home buyers are already a big share of the flow of new mortgages, and this will only add to that.

Q100 **Lola McEvoy:** Is changing the 15% on the cards? Would moving that to a wider share not have been a quicker way to get mortgages out to people?

Andrew Bailey: Given we have so much headroom between 9.7% and 15%, I think utilising that headroom is the sensible thing to do, first of all. We went through the 15% a decade ago, and we have actually reviewed it a lot of times over the last decade. That is a macro point about the consequences of a downturn in the economy—there was a reason for the 15%. I would like to see us get much further up towards the 15%, because that would make a real difference. I am not suggesting this will happen, because there will reasons why not everybody will do it, and it will not be used to the full, but if you asked me, "If the overall number went up to 15%, how many more first-time buyers would that be a year?", it would be about 36,000, and that is not small.

Q101 **Dame Siobhain McDonagh:** Except wouldn't it have been a lot clearer, more understandable and more encouraging if you set a higher limit—if you went up to 20%? The building societies, which are very sensible lenders with a social mission to be of assistance to their members, particularly first-time buyers, recently told me that they wanted to see a limit of 20%, because they wanted to be able to help more first-time buyers. Why not just make it a lot clearer and simpler?

Andrew Bailey: They can get to 20% now. Essentially, the headroom is there. If they want to go to 20%, and they convince us that it is sensible to do, they can do it.

Q102 **Dame Siobhain McDonagh:** But haven't you just made it a lot more complicated?

Andrew Bailey: No. It is actually very simple. We have actually changed the policy overnight and said, "All you need to do is send us an email, ask for"—what we call—"a modification by waiver, and it's yours." One of them has already been through the process—we are a week on—and another is going through the process. I know several more are going to put their emails in any day. This is really very simple.

Q103 **Dame Siobhain McDonagh:** I met with my favourite building society a few weeks ago—the Skipton building society. It is my favourite because it comes up with models of mortgages that are about where first-time buyers are at. Many potential first-time buyers pay huge amounts of rent, pay their rent on time and are good risks, but they cannot borrow enough to get a mortgage. Skipton was really looking at them, as were other building societies—I suppose I should not have a favourite. They are sensible lenders that are keen to help. Would it not have helped them to be able to go to that limit, or do you think that this sector will be the one to go to you and say, "Please let us do this"?

Andrew Bailey: I think the building society sector will be active on this front. I have the same conversations with building societies as you do, so I am expecting them to be leaders on this. I would encourage all your favourite building societies to send us emails.

Q104 **Dame Siobhain McDonagh:** We have to do something, do we not, to help this group of people who are great at paying their huge rents but are not building up towards buying their own home, as we would like everybody to have the opportunity to do?

Andrew Bailey: Yes. You rightly refer to a second point there, which is slightly different but also important, about how prospective lenders can take that into account and ensure that they have the evidence to say that the person has had a good record of paying their rent, and how that can contribute to their credit record.

Q105 **Lola McEvoy:** I was going to ask about those people. Do you want to elaborate on that? I am interested in the 4.5 times earnings element, because some people are paying double that in their rent.

Andrew Bailey: I think most lenders will have an internal limit. It may well be higher than 4.5 times, but they will have an internal limit that they do not feel comfortable going above. That is the case. Dame Siobhain's question, which is important and something we have been discussing with lenders, was about how we can get the fact that a person has been in the rental market, and has established a good record of paying their rent on time and in full, translated into their credit standing. That is an important question as well.

Q106 **Dame Siobhain McDonagh:** Isn't the way in which caps or limits work that most organisations will try to come in under the cap? If the cap is 15%, you know you are safe if you come in at 12% or 12.5%—you are not exceeding it. Will keeping that cap at 15%, even it is an overall cap that can vary, not just liberate some of those organisations?

Andrew Bailey: The difference is that 15% is the overall cap. Up to now, we have applied the 15% down to the level of the firm. We are now saying to them that they can come to us and go above 15%. If they want to build in a margin, they can do that, but they can go higher.

Q107 **Lola McEvoy:** What will be the watermark for that? I am sure lots of people are watching this session at home.

Andrew Bailey: I'm not sure!

Lola McEvoy: If every firm puts in an application tomorrow, what is the saturation in the market for going above the 15%?

Andrew Bailey: We can obviously see the whole market. We can add up the numbers and look at where it is relative to the aggregate 15%, but it has a long way to go before we get to that point.

Q108 **John Grady:** I have a quick follow-up question on the housing market. Page 41 of your report points out Bank staff analysis suggesting that unless there is an increase in housing supply, these sorts of reforms will simply involve more money chasing the same number of properties. That equals house price inflation, which is inevitably followed by a house price crash, as we saw after the Lawson boom and after the global financial crisis. How important is it, Ms Wilkins, that the Government pursue policies to increase the supply of housing?

Andrew Bailey: I think it is very important. We have said for a long time that, in our view, the major constraint in this area is the supply of housing, not mortgages. I think that continues to be the case.

Carolyn Wilkins: I would echo that. I would say that is true not just in the UK, but in Canada, Sweden and Australia. You cannot get around the supply issue. When house prices relative to income are so high, there is no way around it. There is no reduction in regulation that will solve that problem. It will be about the supply of housing and sustainable growth in incomes.

Q109 **John Grady:** So the biggest problem is that we are not building enough houses and increasing the supply—that is what I am taking from both the Governor and Ms Wilkins. Professor Kroszner, are you in the same boat?

Professor Kroszner: Yes, I would agree. It is also an issue in the US. One of the key things is housing supply in particular areas. Chicago is where I am from. It has relatively low housing prices, in part because of the geography: it is very flat in the mid-west, so it is very easy to continue to build houses. In many other areas, zoning makes it extraordinarily difficult, because of either the particularities in the area or the particularities of geography. That is an important issue, and one that countries are struggling with globally.

Q110 **John Grady:** I would like to move on to pension reform. We were discussing the Pension Schemes Bill in the House—it had its Second Reading last Monday, I think. Governor, you have intervened and expressed a lack of support for the backstop power in the Bill, which would mandate certain classes of DC funds to invest a certain amount in private assets and for some of those investments to be in the United Kingdom. Could you talk us through your concerns?

Andrew Bailey: The question I was asked was actually about mandating; it was not about the particular form of it. Can I start by saying that I am a very strong supporter of the pension reforms? The previous Government had very similar intentions, so I do not think there is much distinction there. Reform is essential to the rate of investment in this country, which we need to raise in order to raise growth, including supply-side growth. We have too fragmented a pension fund system, which makes it harder to manage risky assets. I am very strongly in favour of the reforms.

I would also say—I think that the Government understand this very well—that there is a lot of heavy lifting involved in actually doing these reforms. I'm afraid that they are not something that will happen overnight.

On mandating, I think it is important that we let investment markets work. Mandating could have unforeseen consequences, which do make me nervous. However, the other side of the point is that if, as I hope, we go down this road of pension reform, but it does not happen, there is a very strong moral suasion on industry to do this. I do not for a moment want to see a situation where we go through these reforms and they do not happen. Personally, I believe in markets, and I am nervous about the unforeseen consequences of mandating. That is my concern.

Q111 **John Grady:** Are there any foreseen consequences that make you nervous, Governor?

Andrew Bailey: On mandating?

John Grady: Yes.

Andrew Bailey: Well, if it worked seamlessly, it would deliver the result, but I think there are potential unforeseen outcomes that could go in other directions. Would you go down to the level of saying what you mandate the investment in? How micro and detailed is this going to become?

Q112 **John Grady:** On the flip side, the draft legislation contains a reserve power, which is quite specific to the mandate. Do your concerns apply to that reserve power as well?

Andrew Bailey: A lot would depend, I suppose, on how it was used. I hope that we can generate a market mechanism that produces the outcomes we want, because that is a much better place to be. I hope that it would create all the right incentives for pension fund investment. It does in other countries. Carolyn is much better placed to talk about Canada than I am, but Canada has a very different pension system, which generates different outcomes.

John Grady: Do you have anything to add, Ms Wilkins?

Carolyn Wilkins: I would say that the pension funds have a fiduciary duty with respect to their pensioners, which means thinking through which are the right investments to give value. If there is anything about a mandate or reserve power that would direct funds in a way that was not in line with that, that would be problematic. I am not questioning the pension reform in the UK; it is just a fact about markets and how they work. In Canada, there has also been discussion about how much Canadian pension funds invest in Canada, and lamenting that there is not enough—

Chair: We keep hearing about how much they are investing here.

Carolyn Wilkins: But boy, do they invest in the UK! From an economist's and a policymaker's point of view, what is it about the environment that would attract more investment of pension funds, without telling them that they need to do it? What is getting in the way? That is the exercise that is happening in Canada. Then you have an even better outcome: you can improve the investment environment not just for pension funds but for everyone, and, again, you are allowing the market to work.

Q113 **John Grady:** On that, just a quick yes or no: does Canada have mandation?

Carolyn Wilkins: The Canadian pension fund does. In Quebec, there is some public-private collaboration with respect to La Caisse de dépôt, but in general no, not with respect to the Canada Pension Plan.

Q114 **John Grady:** So the point you are making, Ms Wilkins, points to the fact that, in the United Kingdom, we need to create investable propositions so that people can invest in them, and then the rest will follow.

Andrew Bailey: Well, and also have a pension fund system that can efficiently make the investment, which I do not think we do today.

Carolyn Wilkins: Yes, I guess. You wanted a yes or no, and that last statement was a yes. There are some good starting points, because, like I said, there is a lot of investment in the UK on the part of Canadian firms—not just pension funds.

Q115 **John Grady:** One area of potential growth and investment for pension funds—particularly for bigger pools, because they can invest in a wider class of assets—is SMEs. The report is very interesting on this. On page 52, it points out that, "around 80% of SMEs were not seeking access to external finance in 2024", and that, "The stock of SME debt as a share of UK GDP has fallen over the past 15 years, from 13%...to 8%" in about 13 years.

We had Mr Flint from the National Wealth Fund speaking to us a couple of weeks ago, and he expressed a real concern that financial institutions in Britain are not taking on enough risk. That was in the context of this sort of discussion. Are you concerned, Governor, that financial institutions are not investing enough, or taking enough risk, in lending to and supporting SMEs?

Andrew Bailey: We are doing some work—we will be reporting on it in the next FSR, in the fourth quarter, and we will certainly be happy to come and answer questions on it at the next one of these hearings—on financing growth for SMEs with high potential growth rates, because we think that is an important area.

Of course, many SMEs do not want outside financing, and that is a choice that they make, but you are right to point to the fact, as we do in the report, that the share of SME debt has declined. There were bad experiences during the period around the financial crisis—I've still got scars from dealing with quite a few of them at the FCA—and I think that had an effect.

I therefore think we need to be very clear on what, in a sense, the structure of lending is—particularly from the banking system, by the way—because raising access to financing for SMEs is important. That is one thing we will be reporting on. We have said to the Government that we will do that as part of our remit, and we will be happy to come back to you on that.

Q116 **John Grady:** Will that review look at the banks insisting on security over homes, and things like that? I think one thing that SMEs would say is that you go to the banks to borrow, and you have to give security over pretty much everything.

Andrew Bailey: I think we will look at all aspects of this question, and particularly the SMEs with high growth potential, so we will not rule anything out, in that sense, as to how it works.

Q117 **Yuan Yang:** Professor Kroszner, you recently gave a speech about the interaction of financial stability policy on monetary policy. Quantitative tightening has been a topic of hot debates. Do you see any liquidity or financial stability issues from the pace of QT?

Professor Kroszner: It is certainly very important that we monitor exactly those issues. We talk with the Monetary Policy Committee about the choices that they make on the pace of quantitative tightening, and, when there was concern about a sale in April, they postponed that sale. There is a very clear interaction between the Financial Policy Committee and the Monetary Policy Committee to try to assure people that, as the Bank reduces the size of its portfolio, it minimises the chance for risks in those markets.

Andrew Bailey: Can I say, for the record, that the postponed sale happened yesterday? So that is done.

Q118 **Yuan Yang:** Thank you, Mr Bailey. Professor Kroszner, you described the postponed sale and the decisions that were made then. In my understanding, that is a Monetary Policy Committee decision.

Professor Kroszner: It is.

Yuan Yang: What feed-in do members of the Financial Policy Committee who are not on the MPC have in those decisions?

Professor Kroszner: We regularly meet the Monetary Policy Committee. We receive a number of the briefings that the Monetary Policy Committee receives about the macro situation and the macro risks, because obviously it is important for Financial Policy Committee members to have that. A very good, robust discussion occurs on these things. The ultimate governance of that is controlled by the Monetary Policy Committee, but there is a very good interaction, and our concerns and issues are taken very seriously by the Monetary Policy Committee.

Q119 **Yuan Yang:** I am curious about the governance issues that you explored in your speech, given that the statutes give a lot of space for interpretation and for the Bank to decide how to co-ordinate between the two committees. Is there anything that could be clarified or improved about that co-ordination?

Professor Kroszner: As you could see from my speech, I was very positively disposed towards the Bank of England's structure of having a formal Monetary Policy Committee and a Financial Policy Committee, both chaired by the Governor. We do not have something like that in the United States. In some sense, part of my speech was suggesting that as the US thinks about reforming its central bank strategies, it should think about integrating some of these ideas and be much more explicit about integrating the role of financial stability in thinking about monetary policy.

One of the things that works extremely well here is that the stress tests that are undertaken are largely driven by the Financial Policy Committee, so the governance of the stress test is under the Financial Policy Committee. One of the things that the Financial Policy Committee did—before I got here, so I get no credit—was to say that one of the big potential risks coming up is that interest rates might go up very substantially. In the US, they did not do that as a stress test. That was a very sensible thing to do, and it came out of the particular governance structure of the Bank of England. The Federal Reserve should consider not the exact same structure, but integrating those sorts of ideas and, in particular, thinking about financial stability issues when thinking about its stress tests.

Q120 **Yuan Yang:** To clarify, will non-MPC members of the FPC have any formal feed-in or any way of influencing the upcoming August report on quantitative tightening, for example? I will leave that question to the Governor.

Andrew Bailey: Yes. We will invite feed-in. We are in the early stages of that process at the moment.

Q121 **Yuan Yang:** What does the co-ordination between the two sides of those committees look like?

Andrew Bailey: It goes back to what Randy was saying. There is interaction between the committees. We will offer the FPC the chance to express views. That is the way we usually do it.

Q122 **Yuan Yang:** Previously, in MPC meetings with the Treasury Committee, we have explored the impact of QT on the short end of the yield curve, which is of interest to monetary policy transmission. There is another side of the conversation about the long end of the yield curve, and that conversation is not in the room with us when we talk about the topic. Is there any disadvantage to the quantitative tightening decisions being solely MPC decisions?

Andrew Bailey: We have publicly set out three principles to guide, in a sense, how we go about the decisions. I would characterise them as follows. Principle 1 is about the monetary effects of quantitative tightening. Principle 2 is about market functioning, which includes financial stability. I am not sure that the third is a principle, but it says that we will do it in a gradual and predictable fashion. Those are the three things that we hold to. We set up the whole process to answer the questions every year around those principles.

Q123 **Yuan Yang:** If the MPC members who are making decisions on QT are primarily considering the short end of the yield curve, is there a risk that the impact on long-term maturities is not sufficiently taken into account in that process?

Andrew Bailey: Speaking as someone who chairs both committees, as Randy was saying, it is my job and the job of my executive colleagues to ensure that does not happen. By the way, please do not characterise the MPC members as being, in any sense, short-sighted in that respect. I do not find them so at all.

Yuan Yang: No, it is a matter of different hats for different situations—

Andrew Bailey: Yes.

Yuan Yang: And some of you are wearing overlapping hats.

Andrew Bailey: I think that is why the principles are helpful.

Chair: Many hats for the Governor.

Andrew Bailey: I have more hats than I can count. One of the things I find helpful when chairing the process is to say, "Look, we need to make sure we go through each of these principles and do them properly."

Q124 **Yuan Yang:** In our previous hearing, Dame Harriett raised the question of the Bank's analysis of QT's impact on the long end of the yield curve. There have recently been calls in the *FT* from investors and market participants for the Bank to slow the pace for financial stability reasons. How has your analysis evolved over time on that question?

Andrew Bailey: If you do not mind, I will not comment on a live process. Again, going back to what I have said recently—indeed, going back to the first question that the Chair asked me—the staff look very carefully in their analysis at, first, what is driving those yield curve movements. By the way, I do not think QT is driving those yield curve movements, as we were saying in the first question—other things are doing that. I have said it a number of times, and I am happy to say it again, that we need to look at the interaction of those yield curve movements with the QT programme, with market functioning and with monetary policy impact, and that is what we are doing.

Q125 **Yuan Yang:** Ms Wilkins, do you have any views to add on the interaction of QT and the impact on the long end of the gilt curve?

Carolyn Wilkins: Having been part of the discussions on the previous decisions, I am not going to comment on any upcoming decisions. I think the process works well, and we have an opportunity to comment and have productive discussions. It is important that we get that opportunity, for sure. The Governor just talked about the analysis with respect to global factors being the main driver, and how QT is not really driving the yields in a major way at this time—I agree with that analysis.

Q126 **Yuan Yang:** Finally, Governor, you mentioned the April gilt sale, which was postponed and eventually happened yesterday. Can you tell us a bit about the decision making behind the postponement, about when to reschedule it and about who makes those decisions?

Andrew Bailey: The decisions are made by the executive. Frankly, on the April decision, there was too much volatility in markets at the time. Bear in mind that we were in the middle of all the trade policy uncertainty at that point. My judgment, and the judgment of my colleagues, was that it was not a wise time for the auction. I think that was the right decision.

Chair: You have to liaise with the DMO to make sure.

Andrew Bailey: Yes, of course.

Chair: So that will limit—

Andrew Bailey: We told them that it was our intention. We said, "Do you agree?", and—I think they would be happy for me to say this—I do not think they were likely to disagree with that judgment. The decision to do it yesterday was, again, made by the executive. We took the view that markets are calmer now, and that was borne out by the outcome.

Q127 **Dr Sandher:** I want to talk about some of the action around the Bank of England and how that may be affecting financial stability. First, do you think it is important for Governments to have fiscal space to combat financial instability? For example, with the energy price shock, the Government intervened in energy markets to ensure there was a guarantee—that stopped households going under and loans being called in—so it helped to promote financial stability.

Andrew Bailey: Yes.

Q128 **Dr Sandher:** I want to pick up on the pace of QT, and particularly its impact on fiscal space. What do you think has been the impact of QT on fiscal space? What do you say to those who say that the effects of QT have been far too quick?

Andrew Bailey: I think I copied to you the rather long letter I wrote to Richard Tice on the subject, which I hope was helpful. I went into this issue in some detail to get some of the facts on the table, which I thought was useful—I hope it was useful, anyway.

As I said in the letter, there are two ways to look at this question in broad terms. Obviously, you are focusing on the second, which is fair enough, but the first is what I would call an overall economic cost-benefit analysis. That would require us to model the counterfactuals of what would have happened if we had not done QE. If we put that to one side, we are talking here about what I would call the cost of servicing Government debt, as the appropriate lens for these purposes. That is the right way to look at it, I think, and it is the way the public accounts look at it, which is, "What is the effect of QE and then QT on the cost of servicing Government debt?"

As I said in the letter, it is obviously quite a complex area. Broadly, QE takes a set of bonds that have fixed interest costs and turns them into a variable interest cost based on the Bank rate—that is the way to look at it. While interest rates were going down during the decade or more after the financial crisis, that generated a positive cash flow. When interest rates go up, that cash flow goes into reverse, which is a point we have been making since the start of this whole process back in 2009.

The important point I added in that letter was that you then have to look at the counterfactual, which is to say that the UK has historically issued far more debt at longer terms than other major countries—by the way, that is quite a good policy in many ways. That means the UK was able to cut its cost of borrowing, looking quite a long way into the future, by issuing more long-term Government debt when interest rates were very low and the yield curve was low. That is a benefit, in those terms, of both our cutting interest rates down to nearly zero and QE flattening the yield curve at that point. When you do QT, that goes into reverse, but the question is: how much of that benefit do you give up, and how much have you retained? We will try to do some numbers on that to see if we can illustrate it. It requires quite a lot of assumptions, but we will see whether we can do that.

The reason I set this out is because the benefits for the cash flow of Government debt servicing, which is the point you made, are not quite what they seem in that sense. The Government received a locked-in benefit from issuing long-term debt in the past at very low interest rates. I accept that some of that has been given up, but the UK Government still have a longer-term debt maturity than other countries, even after taking QE into account. I think there is still a benefit, and we will have a go at trying to put some numbers on that.

Q129 **Dr Sandher:** I take the point that you bought a longer curve, and from the outset—

Andrew Bailey: That was deliberate from the start.

Dr Sandher: Yes, I understand. My question is really about the pace of QT and the impact it is having on fiscal space and financial stability. To go back to some of the stuff that Ms Yang referred to, postponing the auction of long-dated gilts earlier this year implicitly suggests a recognition of the fact that the pace of QT is affecting Government borrowing costs, and therefore it might need to be adjusted.

Andrew Bailey: No, no—it was market conditions.

Chair: We just heard that very clearly.

Q130 **Dr Sandher:** Of course, the market conditions are around the Government's long-term borrowing costs and their impact on the financial stability of the Government. The idea is that if the bond rate goes up too high, it has an impact on all kinds of financial stability, which goes back to the point about fiscal space. Do you therefore think this has some kind of implication for QT and its pace?

Andrew Bailey: I will have a go at answering it, but that is much more of a question you should ask of the OBR or the Treasury. As I understand it, at the moment, if you put it literally in the context of the fiscal rules—because one of the two fiscal rules is biting—and if you are making the decisions purely on biting fiscal rules, the logic is that we should sell more.

There are two ways in which this cost can come through. One is through the cost of selling immediately, so that is obviously a discount on the sale price. The other is that, if you do not sell, you get it through the cost of carry, because higher interest rates mean paying out more in interest than we are receiving. As I understand the fiscal rules, but you should really ask the experts, the biting fiscal rule indicates that the better thing to do would be to sell more, rather than to take the cost of carry over the long term. To be very clear, we do not take decisions from that point of view, so that is not a motivator.

Chair: Fiscal rules are for the Chancellor.

Andrew Bailey: Since you asked about the fiscal rule, I would just make the point that, if you follow that line of argument, you do not end up in that place.

Q131 **Dr Sandher:** I am not sure that I referred to the fiscal rules. For me, it is the total fiscal cost.

Andrew Bailey: Well, I am making a point about the total fiscal cost.

Dr Sandher: My concern is about how the fiscal cost is impacting financial stability, and I appreciate that it is through a secondary or continuing channel of events. For example, it is estimated that QT will cost this country around 5% of GDP overall—it will cost the US about 1.5% of GDP, and the ECB about 3%. Fiscal space is important, to some extent, for financial stability, so do these considerations have an impact on the pace of QT auctions?

Andrew Bailey: Again, the numbers that you just quoted do not take into account the points I just made. Because of the maturity of the US public debt stock, which is much shorter than the UK public debt stock, the US bought much shorter debt; the UK has a much longer public debt stock.

Right from the start, I think rightly, the Bank of England said that we do not want to distort the gilt markets, so we will buy equally weighted buckets of the maturities, because that is how not to distort the market, which is important. But the benefit, which is not in the numbers you cite, is the fact that the Government have been able to issue a lot more longer-term debt at low interest rates. As I said, QE and QT take some of that back, but they do not take all of it back by any means, which is the point I made in the letter to Richard Tice. The numbers you have do not take that into consideration.

Q132 **Dr Sandher:** Around the pace of QT, can I go back to some of the letters you wrote earlier on financial stability? You wrote to the Committee in May and said, "Introducing minimum reserve requirements could reduce the Bank's ability to utilise their liquidity buffers during stress, which is counter to our financial stability objective." If that was the case and there was a minimum reserve requirement of 1% or 3%, do you think the Bank could still use 97% of its reserves in a liquidity crisis to help promote financial stability?

Andrew Bailey: This is the first half of the letter to Richard Tice. I made the point that we are essentially moving to a policy where we meet the banking system's demand for reserves. That will happen as QE unwinds, and QT does that. Obviously, if you change the terms on which the reserves are provided, the banks will not demand those reserves. That is the point I made in the letter: that to try to count its fiscal benefits would be illusory.

What I also said in the letter—and I think this is your point—is that you could say we are going to mandate a slice of reserves. The ECB did this a bit because, historically, it had a small slice as a minimum reserve requirement. We do not have that in our system, by the way, but it is a very small slice. The point I made in the letter to Richard Tice was that if that was the case, if you locked in reserves and said that non-interest-bearing reserves had to be maintained at the Bank of England, we could not count those in the liquidity buffers because, obviously, they are not available—it is a mandated piece of reserves.

Q133 **Dr Sandher:** It is. First, I think we might have had minimum reserves in the 1970s. But your monetary history will be far better than mine—

Andrew Bailey: Well, yes, in the 1970s, but we do not have them now.

Dr Sandher: They are certainly not unprecedented in British history. The point I am trying to get to is that I am slightly confused as to how having a minimum reserve requirement would reduce the liquidity buffer when it is such a low percentage of reserves.

Andrew Bailey: Because it is not usable.

Dr Sandher: But it is such a low percentage of reserves. You still have 95% of your reserves, which the Bank would be able to use.

Andrew Bailey: Okay. That sometimes gets bandied as a big fiscal benefit, but it is not because it is so small.

Dr Sandher: That is not my question. My question is on being able to use the rest, but I am happy to leave it there.

Chair: We will also have the Governor before us on monetary policy in the autumn.

Andrew Bailey: I look forward to that one.

John Grady: There is no escape for the poor Governor.

Chair: I thank our witnesses very much indeed for their time. I hope you will get a bit of a break over the summer, Governor, before you are in front of the Committee again.

Andrew Bailey: We have the monetary policy decision to do first.

Chair: We have had an interesting session in which we discussed the rising cost of Government borrowing, which the Governor made clear is part of a global trend. We had a good discussion about mortgage lending, hearing that there is a keen appetite from some lenders, who are swiftly getting on to the Bank to extend their lending envelope. We explored how Financial Policy Committee members view the relationship between financial stability, regulation and growth. We had a good discussion about that, and we heard that you do not feel it is a trade-off between growth and regulation, which is interesting and is something we continue to lean into as a Committee. We had a very serious conversation about the concerns raised around stablecoins, and that they will work only with very firm regulation. I think the point about the pound in my bank account and the pound in your bank account was very well made, Governor.

I thank you very much indeed for your time. The transcript, thanks to our colleagues at Hansard, will be on the website, uncorrected, in the next couple of days. Thank you to our colleagues at BowTie for their broadcasting.