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Select Committee on Economic Affairs

Corrected oral evidence: Quantitative Easing

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Members present: Lord Forsyth of Drumlean (The Chair); Lord Bridges of Headley; Viscount Chandos; Lord Fox; Lord Haskel; Baroness Kingsmill; Baroness Kramer; Lord Livingston of Parkhead; Lord Monks; Lord Skidelsky; Lord Stern of Brentford.

Evidence Session No. 1 Virtual Proceeding Questions 1 - 11

Witnesses

I: Professor Daniela Gabor, Professor of Economics and Macro-Finance, UWE Bristol; Chris Giles, Economics Editor, *Financial Times*; Philip Aldrick, Economics Editor, *The Times*.

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Examination of witnesses

Professor Daniela Gabor, Chris Giles and Philp Aldrick.

Q1 **The Chair:** Welcome to this session of the Lords Economic Affairs Committee. For this first session, I am pleased that we have as witnesses: Professor Daniela Gabor, professor of economics and macrofinance at the University of the West of England, Bristol; Chris Giles, the economics editor of the *Financial Times*; and Philip Aldrick, economics editor of the *Times*. Welcome to all of you and thank you for bearing with our virtual sessions and set-up for the committee.

I declare an interest, as this is the first session of our inquiry, as chair of Secure Trust Bank.

Has the expansion of quantitative easing during the Covid-19 pandemic undermined the Bank of England's independence, and what are the implications of this?

Professor Gabor: I would argue that the extension of QE during the Covid-19 pandemic has not undermined the independence of the Bank of England, but it does raise important questions about the need to rethink co-ordination between monetary and fiscal policies.

Questions about central bank independence stem from concerns that the regime of monetary dominance that we have had over the past 30 years is under threat. Monetary dominance means that independent central banks should be in control of macroeconomic conditions; they should keep inflation on target and the financial system stable. They should also operate independently from the fiscal arm to avoid fiscal dominance.

Fiscal dominance is a concept that comes from the Keynesian age of macroeconomic policy that subordinated monetary policy to fiscal policy and required central banks to keep government borrowing costs under control. It is typically argued that fiscal dominance comes with a threat of capture by populist politicians and with inflation.

Some view the ghost of fiscal dominance in the large central bank purchases of government debt since the global financial crisis. To give you the example of the Bank of England, by the big bang of 1986, the Bank had reduced its holdings of government debt to zero. It then returned to the sovereign bond market with the first round of quantitative easing in 2009, and before the Covid-19 pandemic its holdings as a share of outstanding government debt peaked at 28% in 2012. The pandemic-related purchases increased that share to roughly 44% by the end of 2020, just under the Bank of Japan—the central bank of Japan—at 50%. That is still below the 70% limit on the Bank of England's statute.

However, I would argue that these large purchases of government bonds should not be reinterpreted as a return to Keynesian powerful fiscal authorities and emasculated central banks. Rather, what we have now is that the Bank of England and other central banks have adapted their policy frameworks to an evolving financial system. Defined as shadow banking or market-based finance, this financial system is increasingly organised around collateral, and, since the state is the most important collateral factor for modern finance, central bank purchases reflect this new macrofinancial role of government bonds. I call this shadow monetary financing—that is, the monetisation of government debt for macrofinancial rather than for fiscal reasons.

Even if central banks have a significant footprint in the gilt market, they control the terms of this new monetary fiscal dynamic. There is no explicit co-ordination between central banks and the Treasury that subordinates monetary to fiscal policy; there is no change in the economic theories that central banks use to defend the principle of monetary dominance; and there is no attempt from fiscal authorities to reinstate fiscal dominance.

The question is whether this new status quo is desirable for macroeconomic purposes. My answer is no. QE has fiscal spillovers that are poorly theorised and poorly understood, and these fiscal spillovers affect the transparency of QE programmes, which I think we will return to. They affect the effectiveness of QE programmes and they affect the design of fiscal policy measures.

In the first QE round, we academic macroeconomists were rather alone in questioning austerity as a necessary response after the large budget deficits associated with the global financial crisis, but the austerity push in 2010 and afterwards was supported by the view that monetary policy was in full control of macroeconomic conditions. I would argue that reliance on QE alone created what I would describe as a massive failure of fiscal monetary governance in 2010 that inflicted serious costs on the British economy. The economists Jordà and Taylor estimated for the UK that a 1% GDP fiscal consolidation translates into a loss of 4% of real GDP over five years when implemented in a slump, rather than just 1% in a boom.

My concern is that the new status quo of large QE brings us back to 2010 and to a new round of austerity. What we need instead is a framework for co-ordinating with fiscal authorities that is tailored to green and health-friendly objectives. Ten years ago, this was a heresy—

The Chair: Professor, we need to have reasonably short answers and I think we have a clear no from you as an answer to my question. Philip, Aldrick, what is your response?

Philip Aldrick: I do think it undermined the perception of independence at the Bank of England. I do not know if it was a specific decision, but the fact that quantitative easing has matched pretty much to the number, to the pound, the extra debt issuance by the Government during the pandemic has at least allowed criticism of this kind of unnecessary interaction with the Treasury, the sort of implicit impact on its—

The Chair: Mr Aldrick, we have a problem with your sound, so will you put your mouth closer to the microphone, perhaps? You sound very faint;

it is breaking a bit, but go on, please.

Philip Aldrick: I was saying that I believe that there is a risk that the perception of the Bank's independence could be damaged, but that is not the same as the independence itself being entirely written off. The fact is that the Bank can of course reinforce the perception of independence, as soon as inflation starts to pick up, by starting to tackle inflation. But the fact that QE pretty much matched the extra debt issuance to tackle the pandemic does give rise to reasons for thinking that this could be monetary financing.

The Chair: Thank you. Chris Giles, we have one answer that is no and one answer that there is a perception that it might. What is your view?

Chris Giles: I say no, I do not think that it has undermined independence—to date. We have seen, since March last year, announcements of £450 billion of additional QE—essentially half the programme, which is going to take us up to about £900 billion. So there was half done in the first 10 years and half done in two years, 2020 and 2021.

I have not seen any evidence that the decisions taken last year on QE were forced by the Treasury. I do not think that there is any evidence that the Treasury forced the Bank of England to do that, which would be necessary essentially if independence was undermined. I do not think that I have seen any evidence that the Bank of England would not tighten monetary policy if it thought that inflation was getting out of control, so I do not think that independence is undermined. However, I do agree with Phil that the perception of exactly what the Bank of England is doing with QE and the communications around that is rather difficult and has been difficult over the last year.

People in financial markets, including the head of the Debt Management Office, have seen over the past year that the amounts going out in government debts and then coming in from the Bank of England have been essentially identical. That is quite awkward. There is certainly a perception out there in the markets that the Bank of England has been financing government debt.

Q2 **Lord Stern of Brentford:** I should refer to my registered interests, within which I am an adviser on climate to the NatWest Group.

My question is about transparency and whether the Bank of England has been sufficiently transparent in its decision-making processes during each phase of the QE programme.

Chris Giles: Superficially, certainly in the past year, yes, the Bank has been transparent. We know exactly how much the Bank is buying and we know what the Bank is buying, so, essentially, it is all entirely government debt.

When you get down to some more meaningful questions, it has not been very transparent at all, and I will take you back to the November meeting when the Bank of England announced an additional £150 billion of quantitative easing for the 2021 year. We are now £10 billion into that programme. When we asked the senior officials at the Bank of England, "Why £150 billion? Why not £200 billion? Why not £100 billion? Why not zero? What is the effect of different amounts of QE?", in the same way as you would normally ask the Bank those questions about interest rates, there was no reply. Neither the Governor nor his deputies gave a reply. It was apparent that either they did not want to give a reply or that they were unable to give a reply. I think that it is more the latter; there is very little transparency over what the Bank of England thinks additional QE actually achieves.

This was also brought out in last month's report from the Independent Evaluation Office of the Bank of England, which said that there were large knowledge gaps in the Bank of England on the effectiveness of QE and what it is actually doing. We do see that, and it can create poor impressions about exactly what the Bank of England is doing, and misunderstanding.

In that fundamental transparency, the Bank is lacking. It is really rather important because, if you give very powerful tools to independent, unelected officials, you want them to be able to explain what they are doing, to be transparent and to be legitimate in holding those tools. In explaining what it is doing, the Bank has not performed particularly well this year.

Lord Stern of Brentford: Thank you. Lots of us have been involved in decision-making on economic policy at a senior level; they are always judgment calls. Sometimes the territory is charted, and you find it easier to explain your judgment call, and sometimes the territory is uncharted. If the Bank had said that this was a judgment call in uncharted territory, would that have counted as transparency?

Chris Giles: I think so, and I think that would be an entirely fair and accurate reflection. It would have been good to give some boundaries over what they thought they had done. The expectation in November was £100 billion, so they exceeded that by 50%. To say that was a judgment call—"We are not entirely sure. This is roughly in ballpark terms what we think this extra buys us"—would have been an entirely reasonable response. No one is asking for accuracy. We know that we cannot have accuracy in these things, but a little bit of additional transparency over what exactly they are thinking about and their judgment is entirely appropriate.

Lord Stern of Brentford: Thank you very much, Chris. I should emphasise that not everybody has to answer every question, but, Philip Aldrick, do you have anything to add?

Philip Aldrick: Yes. You talk about each phase of the QE programme. I think that in the first phase, after the financial crisis, it was pretty clear that it was an aggregate demand tool; they were trying to boost growth and lift inflation over the long term. There was the added effect of helping bank liquidity.

Since the pandemic, the communication has become increasingly confused. At the start, it looked very much like it was a market stability intervention, with the initial £200 billion in March. Then the matching of the debt issuance began to make it look like ensuring that the Government's borrowing costs could be held down, so a sort of monetary financing aspect, for which there is a legitimate case.

The Monetary Policy Committee then kept on insisting that it was obviously, as a monetary policy tool, a monetary policy action. That is aggregate demand boosting, yet you have actually turned the economy off. Why on earth you are trying to stimulate aggregate demand at the same time as turning the economy off? It just did not add up.

The communications got very confused. I think that it has begun to iron it all out and it seems that the argument is getting a bit clearer that it was a market stability intervention in the very first instance, and then you are beginning to look longer term to the monetary policy aspects, because there is a deflationary impact of having the economy under water.

Understandably, the initial phases were not very transparent. I think that there was confusion in the MPC, and that led to a lack of clarity and some poor communication, which then helped to spur the concerns about whether this is monetary financing.

Lord Stern of Brentford: Thank you. Am I reading you right in the earlier parts of your answer that you are suggesting that the Bank was pursuing both output objectives and price objectives at the same time?

Philip Aldrick: Do you mean after the financial crisis?

Lord Stern of Brentford: Yes.

Philip Aldrick: They were explicit at the time about how QE worked, or what the intention was—to raise GDP and to raise inflation. To go to Chris's point, they have not really spelled out exactly how QE was supposed to work through this stage and this new crisis. You have large sums of money, but you cannot be particularly accurate about how much it has boosted growth—you do not even have a sense of why a certain amount is the right amount.

Q3 **Lord Skidelsky:** Some of the answers to the questions that I want to ask have already been given but I think that there are things to draw out.

Witnesses talked about a lack of transparency. You can have a lack of transparency either because you want to disguise what you are doing or because you do not know what you are doing. Which, in your view, is it? In other words, what is your understanding of what the Bank of England thought it was doing in the last 12 months?

Professor Gabor: Maybe combining the answer to Question 2 and this question, the Bank of England has an idea of how quantitative easing works. There is a transmission mechanism of quantitative easing that is supposed to work through a portfolio rebalancing channel, through a signalling channel and through a bank lending channel. These are moving parts that interact with each other. The Bank of England does not have sufficient theoretical tools to work out a precise number for the size of quantitative easing interventions, and it does not take into account what the Independent Evaluation Office points out, which is the linkages or interactions between monetary and fiscal policy. In that sense, it is quite difficult to ask the Bank of England to be more transparent than it is, since it does not have the theoretical tools to do so.

That is one important lesson that we have learned from QE during the pandemic: the Bank of England needs to take seriously the recommendations of the Independent Evaluation Office, and to develop and research more carefully the monetary fiscal interlinkages.

There have been recent reports in the media that investors now believe that successive rounds of QE have dampened the signalling channel of monetary policy and that the Bank of England purchases basically work now through a public sector channel which is supporting government borrowing costs. I have difficulties with this explanation because I think that opposing the signalling channel and the public sector channel is problematic. The signalling channel does not work as well as we assume. If it did, the Bank of England could have resumed the pure inflation-targeting approach and said that short-term interest rates would be kept at zero. So, there is no scientific way of arriving at the precise number, and we need more research into working out the fiscal implications of QE.

Lord Skidelsky: May I hear from the other witnesses, please—Philip and Chris?

Philip Aldrick: You ask whether the lack of transparency is through hiding or lack of knowledge or clarity in the economy. I think that it is basically the latter. The confusion is not over the Bank of England deliberately trying to hide anything; I think it is a difficulty in communicating a very complicated set of circumstances. I would not attribute it to any sort of nefarious hiding.

Chris Giles: I agree with Phil that there is no underhand action going on, but I think that we should play out a very small mind game when we are thinking about what has actually been going on over the past year.

If you play the mind game and ask what would have happened had the Treasury not had any action to loosen fiscal policy—no furlough scheme, no support for companies—could monetary policy have offset the damage to the economy by the amount of QE or more QE? I think that it is highly implausible that monetary policy alone could have helped the economy.

Fiscal policy is definitely in the driving seat here. Fiscal policy has been supporting and saving our economy over the past year, and monetary policy has been playing second fiddle in some way to that. Just like in an orchestra, playing second fiddle is very important—otherwise we might well have seen interest rates in government bond markets rise or do things that were unhelpful—but it is not the primary driver of what has been happening with the support for the economy.

It gets difficult for the central bank, particularly when it is responding to fiscal policy—when fiscal policy is the primary tool of economic stabilisation, which, in my opinion, it definitively is at the moment.

Lord Skidelsky: The co-ordination of fiscal and monetary policy is a big topic. I am very surprised to hear you say that the independence of monetary policy has not been compromised, when in fact the Bank has been financing the fiscal policy of the state in the last year. The fact that there has been no official recognition of this does not, surely, hide the reality that the Bank has been acting as an agent of the Treasury, and had it refused to do so, the Treasury would not have taken that lying down.

What is this operational independence to set interest rates in disregard of government policy? We are in the realm of fiction a lot of the time, as I see it, not reality, when we talk about the continuing operational independence of the Bank of England.

Chris Giles: My feeling is that we have not tested that accusation or theory yet. The test would come when the Bank of England had to do something that the Treasury actively disliked, such as raise interest rates to meet the inflation target. We have not seen the inflation target under threat yet, as in moving above the 2% target. If and when we do so, that is when the real test will come, and that will be when the Treasury will have to decide whether it uses the ways and means account in the Bank of England directly to finance its budget or have it done as it has been done over the past year, where the Bank of England has taken decisions on QE that have essentially mirrored the borrowing that the Treasury has undertaken.

I do not think that we have been tested, but we will be tested at some point in the future. That is the real moment at which we will know whether the situation over the past year has been entirely appropriate for the economy, and whether the Bank of England has been, ultimately, determining the inflation target or just been the agent of the Treasury. I do not think we can take that view immediately.

The Chair: Okay. Are you happy with that?

Lord Skidelsky: I agree that it has not been tested, but when people talk about integrating or co-ordinating fiscal and monetary policy, there is a lot of vagueness about what that actually means. That is not just a problem of communication, is it? It is also a problem of not knowing what it means.

Professor Gabor: Lord Skidelsky, if I may add, it is not just the Bank of England that has been intervening directly in government bond markets; it is every other large central bank in the world. To my mind, this reflects the fact that government bonds do a lot more than help governments finance their budget deficits. The Bank of England is very clear that the reason it wants to bring government bond yields lower has to do with easing private financing conditions. You cannot get away from that; you cannot let government bond deals rise and at the same time have an unconventional monetary policy regime where you want to keep financing costs for households and corporations low in order for aggregate demand to increase and inflation to return to target.

Lord Skidelsky: Thank you. I am through.

Q4 **Lord Monks:** Following on from that little debate, when I was at the TUC we always used to argue with the Treasury that the mandate of the Bank should be set more widely than it has been set, with the current emphasis, formally, on inflation control and controlling public expenditure to some extent and what the Executive does.

We argued that it should follow the Federal Reserve mandate and include high employment—full employment—as part of the mandate. Since then, the Bank has been sucked into all kinds of things, particularly in this area of QE, which are new and novel, and certainly high employment has been an expression I have heard a lot of times from senior Bank officials.

In the light of that, I would like to ask our witnesses whether they think that the mandate should be changed—that there should be some formal recognition that the Bank has changed territory; not that it has given up on inflation control, but that it is only one of a number of objectives that it has either been set or has set itself.

Philip Aldrick: The Bank has a secondary mandate, which is to support the Government's economic policies, and obviously not having mass unemployment is clearly a key economic policy of government. You feel like the employment remit has been sort of snuck in through mandate remit 2, as it were.

The only thing that I would change with the mandate is to switch it from CPI to CPIH, and raise it to 2.5%. Because CPIH includes housing costs, it is a better measure of inflation and tends to be a little bit higher than CPI. Effectively, it is the status quo, but just a better-quality inflation metric.

Chris Giles: I think that the age at which we can have the broad structure where the Government give the Bank of England an inflation target, which the Bank of England meets with monetary policy, taking into account fiscal policy as a given, for the time being has gone, because fiscal policy is doing the main stabilisation for the UK economy at the moment.

The Bank of England Monetary Policy Committee, even though this would be very difficult for it to do, does need a duty to say if it feels it does not have much ammunition left. I can see a situation arising in the next few years where the Government might decide to take some reasonably medium or short-term action to stabilise the public finances, assuming that the Bank of England can offset that with monetary policy when it just cannot. That would be potentially very damaging for the UK economy and it would be a good thing for the Bank of England to be forced formally to tell the Government if it felt it was essentially out of ammunition.

In the longer term, you would not want that; this sort of clause would be only an escape clause. In the longer term, you would probably want the monetary policy to be the tool of macroeconomic stabilisation. I think that we have learned over the past decade or so that, in an era of low interest rates, having a 2% inflation target makes that quite difficult because you are more likely to be at the lower bound for longer.

In the very long term, you might well want to raise it, which would of course be a very difficult trade-off between the advantages of having a higher inflation target and the disadvantages of moving towards that with all the inherent costs that it would imply. That is a difficult trade-off for government to think about, but it is a trade-off that I think we should think about.

The Chair: That takes us on to a question that Lord Livingston wants to ask. You just touched on that, Chris Giles. Lord Livingston, do you want to ask your question?

Q5 **Lord Livingston of Parkhead:** I have two questions. You mentioned running out of tools. Professor Gabor, do you think that we have reached the limit of QE, either because of the amount of QE that is out there or because the nature of this crisis is that QE is not the answer to the question?

Professor Gabor: Thank you. I think that QE is a necessary tool, but it is not sufficient. It is structurally necessary because of the importance of market-based finance in the British financial system. For the Bank of England to be able to stabilise the British financial system, it should be able to do market-making of last resort in government bonds, so we will see this repeated intervention in government bond markets. For that to change, we would need structural reform of the British financial system that I do not think is on the cards yet.

Why is it not sufficient? First, because the UK financial system is not effective enough in mobilising productive finance. The fact that we had a working group convened in 2020 between the Treasury, the Bank of England and the Financial Conduct Authority to understand better how to mobilise productive finance is a recognition, in my view, that QE is not sufficient.

The second reason I think QE is not sufficient is that it has not led to a transformative change in the relationship between monetary and fiscal policy. Here I would agree with the other two witnesses that we cannot assume that monetary policy can do all the heavy lifting in a crisis if fiscal policy cannot fully play its role.

I want also to mention and reinforce—I was not given a chance to talk about the expansion of the mandate—that I think it is necessary for the

Bank of England mandate to be clarified in relation to the climate crisis, with the possibility and necessity of financing a low-carbon transition.

The Chair: I apologise that you were not given a chance, but I cannot fit in three answers for every question unless the answers are very short.

Lord Livingston of Parkhead: I will switch to Philip Aldrick's article on Saturday in the *Times*, but feel free to comment on my earlier question as well. You proposed that there is a real problem in getting out of QE and that the interest rate that the Bank of England pays the banks as part of QE should be set at zero. Do you want to say something about that and why you think that it is a good idea?

Philip Aldrick: Yes. It is a sort of early-stages idea, but the coupon on the gilts is being paid to the Bank and then it is handing it back to the Treasury, so that is irrelevant to the costs of QE now; the only cost of QE is the cost of issuing the reserves—the money printing, as it were. So those reserves are remunerated at that Bank rate.

Before the financial crisis, before QE was introduced in 2008 in America and in 2009 in the UK, there was a zero-interest rate on Bank reserves. The Bank manages the transmission of the policy rate into the markets. It used to do it through open-market operations—buying and selling particular bonds and securities off the banks before the financial crisis—but now it is introducing this interest rate on all these reserves. That is the way in which it transmits the interest rate into the markets.

It is very complicated, but, at the long end, to sum it up, if you could remove the interest rate on reserves, you have zero money being paid from the Bank on that £875 billion of QE that has been issued and the coupon is just transferring back and forth between the Government. So you have basically got this pot of money, at no cost to—

Lord Livingston of Parkhead: Will the banks be a little unhappy about this tax?

Philip Aldrick: It effectively works as a tax on the banks because they would have reserves that they would be unable to use. It was an idea floated by Charles Goodhart, a former MPC member, but there is the seed of something that could be used there.

The issue is that it would require legislation, and there clearly would be lots of things that would be complicated about implementing this. But, ultimately, the point is that you had a situation where the reserves were not remunerated at all, and now you have a situation where the coupon is just transferring back and forth across the Government. If there is some way of organising this so that the reserves go back to being not remunerated, the QE could effectively just be siloed, and the debt would be reduced by 30%.

It sounds like "magic money tree" stuff. I am curious about whether there is any way of making this happen, because at the moment it is debt going from one part of the Government to the other.

Lord Livingston of Parkhead: Chris, is there anything you want to add on either of the questions?

Chris Giles: No, I will leave it at that.

Q6 **Baroness Kramer:** If we could stay on the same theme, what do you think the main risks are from continuing to expand QE? Obviously, the word "inflation" comes into that, but Professor Gabor talked about fiscal spillover, and, Chris, you talked about the Bank of England being out of ammunition when it is going to be needed as we move into the future. Philip, I think that you raised the spectre of a national economy very vulnerable to even the smallest increase in short-term rates. Could we start with Professor Gabor here, and try to bottom out some of the risks?

Professor Gabor: I will address the first point you raise, which is that there are voices concerned about the inflationary aspect of significantly larger central bank balance sheets. I am not too concerned about these inflationary threats, in the sense that we know that commercial banks do not multiply central bank money. This is a money multiplier mechanism that exists only in the textbooks of universities, not unlike mine, that do not reflect very well the way in which bank loan creation works, so I am not worried about inflation.

I would argue that, on the contrary, for the period since 2008, with significantly larger central bank balance sheets, central banks have been fighting too low inflation instead of inflationary pressures. However, the risk—and I know I will sound like a broken record, but to me it is the most important risk—is that the governance failure of 2010 is again repeated because the Bank of England perpetuates the illusion that somehow through quantitative easing it is single-handedly able to tackle the aggregate demand problems of the British economy instead of designing mechanisms of better co-ordination with the fiscal authorities.

Baroness Kramer: Perhaps, Philip, you could just expand on your concern, and does that feed into expanding QE?

Philip Aldrick: As I was describing, the cost of QE is no longer really the coupon on the gilt. My concern is that everybody wants to borrow at these extraordinarily low rates for the long term to invest in the future growth in infrastructure and to get the economy going. But if you are buying these gilts through QE, you are basically taking what would be a 20-year gilt at 1% to 1.5% for 20 years and turning it into an overnight deposit, which, if there is the threat of inflation—there are very good arguments to say that inflation is coming down the line in the next couple of years—would mean that interest rates will go up. That goes back to the Bank of England independence.

The Bank will demonstrate its independence by raising rates, in which case the cost of the Government debt is no longer this 20-year issue but an issue that is now, overnight, costing 2% to 3% on the base rate equivalent, rather than the 1% that you might have got had you kept the bond in the market for 20 years.

Baroness Kramer: If I might follow up on that, is it your feeling that the vulnerability to any increase in short-term rates or variable rates is already a real risk, or are we at the point where it is containable but that if we go further it becomes a serious risk?

Philip Aldrick: It is already a risk. We have already done so much QE. The OBR made this point in the November spending review, so it is already a significant risk. Half of our conventional gilt stock—and that is the bit where you can lock it in because it is not linked to the inflation rate—is now effectively owned by QE and has less than a year's maturity, so it is already a concern, I think.

Q7 **Baroness Kingsmill:** The question I want to ask after this very interesting discussion is whether QE is with us for ever. Are we always going to have it? Is it going to get unwound? Should it get unwound? Will it be unwound in full? Is this a permanent feature of our management of the economy, or is it just in cases of crisis, which is what it originally was?

Chris Giles: I think that it is going to be with us for as long as interest rates are effectively on the floor. When aggregate demand is sufficiently strong to have interest rates again, you can imagine it being unwound. I presume that it would be unwound by letting the debt run off slowly—in which case it would be with us for a very long time—as the debt matured and the Government took on the liabilities.

Of course, that means that we would then have as a nation a much larger interest bill to pay, but that would essentially be a good thing because we would be in a situation where we had sufficient aggregate demand such that we did not have emergency interest rates at effectively zero any longer. It would mean a bigger burden for the public finances to support every year, inevitably, because we have had to take on a huge amount of debt to pay for the pandemic.

Baroness Kingsmill: Indeed. To go back a little in the discussion, it also seems possible that a public interest mandate would be appropriate and not simply something quite as narrow. Given that it is likely to be a long-term feature of monetary policy, it would be quite a good idea to introduce a public interest element to the mandate.

Chris Giles: Essentially, the Bank of England would presume, and I would not disagree with it, that everything that it does is effectively in the public interest. In fact that is its mission statement: to do something for the public good. I have forgotten exactly the mission statement of the Bank, but it is very hard to say that there would be a separate public interest condition on top of its mandate given by the Government. It would be very hard to manage the two together.

The Chair: Okay. Does anyone else want to pick up on that?

Professor Gabor: I would add that it is important to know that central banks can conduct a short-term interest rate policy with a structurally larger central bank balance sheet, so it is not necessary to shrink the balance sheet of the Bank of England or to increase interest rates and policy rates above zero.

There is an interesting paper from the Bank for International Settlements that demonstrates that and raises questions about the possibility that Philip Aldrick alluded to that the Bank of England will get rid of remuneration on excess reserves.

To me, the question of unwinding QE is that it happens too soon and too fast, and puts undue pressure on the fiscal stance. My recommendation here would be in line with that of the Independent Evaluation Office: that the Monetary Policy Committee should not contemplate any unwinding until the Bank has produced substantive research on the fiscal monetary interlinkages and the impact on aggregate demand.

The Chair: Philip Aldrick, do you want to add to this?

Philip Aldrick: Rather than the fiscal monetary interplay, I am more worried on QE about the financial stability in monetary interplay. In financial markets at the moment, we have the worst recession in 300 years, and we have bond markets and stock markets at record highs. There is something crazy going on, and perpetually low rates and the massive monetary stimulus that is going into markets rather than directly into the economy would be my concern.

Baroness Kingsmill: You mean the gap between the real economy and the—

Philip Aldrick: Yes, this disconnect between what is happening in markets and what is happening in the real economy. I think that QE is causing bubbles.

Lord Fox: We are going to come to that.

Philip Aldrick: There is a reason for it, but—

Baroness Kingsmill: That is what I meant by the public interest, but thank you.

Lord Haskel: As this is my first appearance, I have to make a declaration of interests. I have no commercial or financial interest to declare, but I do have a family interest, as my son Jonathan is an external member of the Monetary Policy Committee. If members of the committee feel that I will be unduly paternalistic or influenced in some way, I will gradually recuse myself from this inquiry. Many people on the call know him, and I just want to make that declaration.

The Chair: Lord Haskel, we know you from previous committees to be very independent-minded, so I do not think that we have any anxieties about that.

Q8 **Lord Haskel:** Thank you very much, Chair.

My question follows on from Lord Skidelsky’s question about primary purpose. What effects did the Bank of England originally hope would come from quantitative easing, and how successful has it been in the terms that the Bank of England originally thought?

Chris Giles: In February and March 2009, we were in the teeth of the global financial crisis, and the original motivation of QE was to provide greater monetary stimulus to the economy through a variety of transmissions to the real economy. Those transmissions were that it would lower the longer-term interest rates once short-term interest rates were to the floor, and that was pretty successful. In early 2009, the 10-year government bond yield was 3.8% or so, and by 2012, it was 1.6%, so long-term yields certainly came down and that provided some monetary stimulus. It wanted to get people to invest in more risky assets, and certainly the prices of those risky assets also rose in that period.

I think that it also has some effect in helping Governments finance their deficits. We know that it certainly had that effect. Since then, we have seen quite a bit of inconsistency from the Bank of England in how it likes to describe how quantitative easing works. There is one thing that has been consistent through the past 12 years or so: that the Bank always said that it is working. It never has any doubt that it is working, but it has often changed the way in which it says it is working.

Lord Haskel: Generally, you feel that it does work. Philip, do you agree?

Philip Aldrick: I believe that it did work in 2009. It was certainly effective when we needed to bring the effective interest rate below 0.5% to provide stimulus to the economy. We were staring at a 1929-style financial crash and the great depression that followed. We were right there. In the end, we ended up with a 6% recession and 8.5% unemployment, so if you looked at those measures, you would say that it was definitely a success; we came through that.

Are there side-effects? There are concerns about low rates and that QE could be zombifying companies; people worry about that impact on productivity and the financial bubbles that have been caused. There are all sorts of things. There are things that have possibly restricted or restrained our subsequent recovery because of QE, but at the same time it has been there supporting aggregate demands and supporting growth.

I would say that, overall, it has been good. In the pandemic things got a bit messy, though, as I was saying earlier.

Lord Haskel: Thank you, so you also agree that it has been good. Daniela, what is your opinion?

Professor Gabor: I would say that on the measure of QE allowing quickly, or eventually, the Bank of England to leave the zero lower bound and to return to its normal inflation targeting regime, it has not been successful at all. We have had five rounds of quantitative easing and we have a central bank that does not quite clearly understand the transmission mechanism of monetary policy.

It has not been successful on those terms. Unlike Philip, I do not think that interest rates will rise very soon or that inflation will rise very soon again.

Lord Haskel: Thank you. We have conflicting views, Chair, which we will have to take into account.

Q9 **Lord Fox:** As an observation, I wonder whether those conflicting views could be the fact that there are two different animals here: QE during the financial crash and QE for Covid. I wonder whether the respondents might briefly acknowledge that.

My question comes back to what we touched on just now—the distributional effects of QE. Phil Aldrick began to touch on the fact that it seems to be inflating one part of the economy. Phil, has it resulted in disparity in the increase in wealth of certain parts of society? Have we got evidence for that, and where should we look? Professor Gabor might follow up on that.

Philip Aldrick: Yes. I think that it does increase inequality, and that is one side-effect of QE. The Bank produced a paper in 2018 that effectively showed that households on lower incomes were protected—employment was protected, so their incomes were protected. Wealthier people, whose jobs were already safe, got the wealth effect of QE pumping up riskier asset prices. It calculated that, basically, the effect was 10% on poorer households and 10% on wealthier households, so if you look at the Gini coefficient of inequality, it was even; QE was completely neutral to inequality.

If you look at the actual numbers, you see that 10% on the lower income households was £200 a year more, and on the wealthier households it was £195,000 a year. I know that one set starts with more money than the other, but it is hard to square a £194,000 difference in people's accumulation of wealth as a result of one policy without to my mind saying that that is clearly a policy that leads to greater inequality.

Professor Gabor: I can add only that the distributional effects of QE are very strongly debated in the literature. One can find studies to support one position or another: that QE has increased inequality because it supports the income of the owners of financial assets, whereas other studies argue that the employment effects and the impact on mortgage rates are very important.

I would argue that there is also an unexplored channel that has to do with the monetary fiscal distributional effects that have not been investigated, in the sense that overreliance on QE may accommodate fiscal retrenchment, which has a very significant impact on inequality. In a nutshell, we do not know enough about this and we do not have enough time to debate it.

I would argue that questions of inequality and wealth distribution should be explored in the broader context of the political choices that we have made about how we organise our credit creation system and how we organise our macroeconomic policy architecture.

Lord Fox: On the balance of that evidence, in your opinion, Professor, does it or does it not have an effect on inequality?

Professor Gabor: I cannot say that it has a positive or a negative effect.

Chris Giles: I think that this is an area that is obviously very difficult because the counterfactual is very difficult. "What would have happened had we not done QE?" is the relevant question. That is rather difficult. I fully accept the Bank of England's position on income inequality—that had we not done QE we would have likely, after 2009, had a much weaker recovery, and that would have been very bad for the bottom end of the income distribution and people's jobs. I think that, there, QE almost certainly helped to lower the inequality of income.

Wealth is much less convincing, and I think that I would agree with Phil on wealth. There has definitively been an increase in asset prices, but we should also remember that wealth inequality in the UK in recent years has hardly risen, because, effectively, the biggest wealth that most people own is their homes and lots of people own them. That goes rather down the wealth distribution, so there has not been a large increase in wealth inequality.

Where there has been a big increase in inequality over the past decade, and I think QE is almost certainly responsible for this—it is in the Bank of England's 2018 paper, but it rather buried it and did not put it in the main report—is intergenerational inequality, whereby particularly the rise in house prices that has accompanied very low interest rates over a prolonged period has definitively helped people in my generation, and in the older generation, and hurt people in the younger generations. That is where QE has had a particularly difficult effect on inequality.

Lord Fox: Thank you. I should have declared that I have no relevant interests in this report.

The Chair: Thank you very much. I ask Lord Livingston to take the Chair. We have two more questions from Viscount Chandos and then Lord Bridges, but please excuse me, as I have to make a speech in the Chamber.

In the absence of the Chair, Lord Livingston took the Chair.

Q10 **Viscount Chandos:** Through portfolio balancing, QE is meant to push investors to higher-risk assets. Is there any evidence to suggest that that has gone too far and pushed them into excessively speculative assets? Chris Giles, do you want to start?

Chris Giles: I do not think that I am hugely qualified to answer. I think that we are seeing quite a lot of speculation in financial markets at the moment. We have seen a lot of search for yield as interest rates have remained very low. Whether this is directly the consequence of QE I think is debatable. I think it is more the consequence of long-term global low interest rates that has caused this speculation and search for yield.

Professor Gabor: I agree. I would add that if the intention of the portfolio rebalancing channel was to move the demand for credit into assets that help the real economy and productive investment, that ambition has not been realised. If we look at the corporate part of the QE programme, the Bank of England has made the climate crisis worse because there is a very pronounced carbon bias in its corporate bond purchase programme. In that sense, if the speculative asset of the future is high-carbon assets, then QE has certainly made things worse.

Philip Aldrick: The £200 billion of QE in March was deliberately done to stabilise, or certainly one interpretation was that it was done as a market stability operation—it was effectively market-making of last resort. That was, I would say, actively propping up markets. Obviously, that was putting in a floor so that we would not fall any lower—the Greenspan put, and the central bank put. It is generally accepted that markets believe that the central banks will always stand there if there is a problem and lift asset prices and be the safety net. I cannot bring any specific evidence to mind, but there have certainly been numerous academic papers and lots of commentary about how the central bank put is effectively pushing up asset prices.

The bigger effect, as Chris and Daniela say, is probably due to long-term interest rates being at historic lows. But I do think that this central put, and the fact that, in March, it actively demonstrated that and gave markets free support, as it were, has helped to prop up asset prices and given that bubbly aspect to things.

Q11 **Lord Bridges of Headley:** I should start by declaring an interest as an adviser to Banco Santander.

This has been a great discussion. To draw some strands together, may I ask a very simple question, starting perhaps with Phil, then Chris and then Daniela?

QE has gone through different phases. What were the alternatives to QE in each of those phases, and do any of them still apply and exist? We are running quite over time, so we better have pretty short answers.

Philip Aldrick: QE was the innovation of its time. I do not think that any other policy tools were genuinely being considered in 2009.

We then had forward guidance, which I am not convinced did anything more than what central bank signalling had been doing for years before. Now, obviously, we have negative rates, which have been in use in certain countries since about 2014. Negative rates are on the table. Obviously, the Bank is trying to put that tool in the toolbox, so that could be used in future—not very much, though. It is not making much monetary policy headroom with the negative rates.

Chris Giles: To add one thing to what Phil has said, to the extent that QE is attempting to maintain control over long-term interest rates, particularly of government, of the safe asset of a nation, the obvious alternative is some form of yield curve control—rather than declaring how much you are going to buy, declaring that you will buy sufficient government bonds to ensure that interest rates at the long end of the curve do not rise above a certain level. This has happened for many years in Japan; and yield curve control has happened in the eurozone as well. If you are worried about spending £900 billion and you think that the Bank of England is a credible institution—and I do think it is a credible institution—then I am sure that that would be a far cheaper way of ensuring that interest rates at the long end stayed low, rather than spending the money.

Professor Gabor: Let me just reinforce that message. Yield curve targeting was on the table in 2003. The Federal Reserve looked at it, not within the unconventional policy measures, but it is there. It has been experimented with before. The Bank of Japan has done it since 2016, and it probably would provide the Bank of England with a better framework for intervening in government bond markets than through QE.

The Chair: I thank all the witnesses, Professor Gabor, Chris Giles and Philip Aldrick, for your very interesting evidence. Your time is appreciated.