



Select Committee on Economic Affairs

Corrected oral evidence: Quantitative easing

Tuesday 23 February 2021

3 pm

Watch the meeting: <https://parliamentlive.tv/event/index/e187f43a-654b-43ca-9654-4664216589d5>

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

Evidence Session No. 5

Virtual Proceeding

Questions 41 - 48

Witness

I: Melissa Davey, Director, Independent Evaluation Office of the Bank of England.

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.
2. Any public use of, or reference to, the contents should make clear that neither Members nor witnesses have had the opportunity to correct the record. If in doubt as to the propriety of using the transcript, please contact the Clerk of the Committee.
3. Members and witnesses are asked to send corrections to the Clerk of the Committee within 14 days of receipt.

Examination of witness

Melissa Davey.

Q41 The Chair: Welcome to the Economic Affairs Committee. I extend a warm welcome to the witness for our first session, Melissa Davey, who is the director of the Independent Evaluation Office of the Bank of England.

Perhaps I may begin by asking the first question. How well does the Bank understand its QE programme?

Melissa Davey: Thank you very much for inviting me today. I thought it might be useful to say a little about our role at the Bank and the context for the QE evaluation, if that is all right.

The Chair: If it is not too long, that will be fine.

Melissa Davey: It will not be too long. The Independent Evaluation Office is an independent unit of the Bank. We report directly to our chair of court, Brad Fried. Our aim, very much like that of your Lordships, is to support the Bank's accountability and learning.

Since the IEO was set up in 2014, we have carried out around nine evaluations, starting with forecasting. Our evaluations look at the Bank's policy areas and consider the inputs into the infrastructure surrounding, and the outputs of, policy decisions. This QE evaluation was commissioned by the Bank's court in 2019. We were asked to carry out an end-to-end evaluation of the QE process, looking at the Bank's understanding of the tool, design and operationalisation, governance and risk management, and communications.

Of course, while we were carrying out that evaluation, the MPC expanded purchases further. Although the scope of our evaluation was to look at the programmes up until 2016, we looked at last year's QE rounds to the extent that we saw there had been learning from previous rounds of QE, or where issues that we had already identified were brought into sharper relief. That is the context for the evaluation.

Turning to your question on the Bank's understanding of QE, as we say in the report, the Bank has significantly advanced its understanding of QE since it launched the programme in 2009. A really important context is that the Bank was starting from a standing start. Before the Bank and the Fed started QE in the financial crisis, it had only really been used in Japan, so there was not a lot of evidence on how QE worked in real-world situations.

We saw the Bank prioritise learning about its new tool in the early years. In the report, for example, we show that some of the Bank's early research in this area was particularly influential. When we talked to people both in the UK and internationally, they were still citing some of the Bank's early papers on the impact of QE as influential in their thinking.

We saw that the Bank's work on QE tapered off slightly when it was not being used as an active policy tool—for example, as it considered other forms of loosening, and then tightening, policy. We thought that it was important for the Bank to consider thinking about investment in its policy tools, even when it may not want to be using them in the immediate future.

One area where we thought that that could be an issue was when the MPC started to think about wanting to use QE again in 2016. Bank staff had to act at some pace to design the corporate bond purchase scheme. That is not to say that we saw any particular issues with the design of that scheme, but we thought that, if the Bank had spent more time in investing in its understanding and thinking about its policy toolkit in peacetime, it may have been more ready to draw on that new sort of scheme when it came to the referendum vote in 2016.

As regards the work that the Bank has done, we should be clear that it has a view on how QE works, and it has estimates on the impact of QE on GDP and inflation, which it has continued to update over time. When we looked at that work, and when we talked to people outside, we found that there were still some significant knowledge gaps. If useful, I can outline what we think those knowledge gaps are.

The Chair: That would be very helpful, focusing on the specific knowledge gaps.

Melissa Davey: One challenge is that, although we now have more evidence on how QE works, it has of course been used as an active tool for just over 10 years in the UK, so there is still a limited evidence base to draw on. That is particularly the case when you consider the fact that QE is likely to be state contingent, so it might have different impacts depending on the conditions in which you are using it.

Some of the unanswered questions that people raised when we talked to them were on the QE transmission mechanism. The Bank has had a fairly stable core story about how it thinks QE works. Communications over the years have often emphasised the portfolio balance channel. In recent years, in particular, we saw increased weight in communications on signalling, so QE working through lowering expectations of longer-term interest rates.

To some extent, it does not necessarily matter which channel you put most weight on when you are thinking about the impacts of the policy. In some circumstances, your view on QE's impact may differ depending on how you think it works. That may particularly be the case, for example, if you start to think about unwinding. That is not a purely academic question, and we thought the Bank needed to do more work on which elements of the transmission channel it thinks are most powerful.

We also thought that there were still some unanswered questions on the impact of QE on growth and inflation, which is, ultimately, what we care about, of course. This is not unique to the Bank. There is a box in our

report that looks at the research and analysis on QE. You see that there is a lot more research focused on the impact of QE on financial markets than there is on its broader macro impacts. That is not that surprising. It is a lot easier to isolate the impacts of the policy on financial markets. You can do event studies that look at moving gilt yields, say, on QE announcements. It can be a lot harder to isolate the impact on growth and inflation where the lags are longer, and the counterfactual—what would have happened if the Bank had not done QE—much more uncertain.

The Bank has estimates of the impact of QE on growth and inflation. We have seen those estimates change over time as the Bank has got more evidence, but we think that there is probably still more learning to do, in particular linking the circumstances in which you are doing QE to the impacts that you expect it to have—the state contingency of the policy.

The Chair: Sorry to interrupt you. It may not be surprising, but is it not a little alarming?

Melissa Davey: As I say, the Bank has its central estimates of the impact that it thinks its policy has, which it uses in its analysis. But, as with many economic concepts, we are always learning about those impacts. The Bank draws not only on its own analysis, but on that produced by other central banks and the academic community. The consensus out there is that QE supports growth and inflation, which is its intended purpose.

The Chair: Why do you think the MPC has been reluctant to provide a collective view on how it thinks QE supports the economy?

Melissa Davey: The Bank put out a number of pieces on this, particularly in the early days. There were a number of *Quarterly Bulletin* articles, for example, and *Inflation Report* boxes that set out a view of the transmission mechanism and the impact.

We have not seen a collective update recently. Individual MPC members regularly give speeches on this topic. In part, that might be because individually accountable MPC members can have different views on precisely how the tool works, but we think that there will be central messages that they can coalesce around, so that you can put out a best collective judgment on how you think that tool is supporting the economy.

Indeed, we think that it would be useful for the Bank to highlight how it thinks the tool is working, and to give its best collective view, and to highlight where there are disagreements and remaining uncertainties. That would help from an accountability perspective, and, by being clear on where there are still uncertainties and knowledge gaps, it could help in focusing the minds of people outside the Bank on useful places to focus their research, giving the Bank a broader set of information to draw on.

Q42 **Lord Bridges of Headley:** Let me apologise in advance, as I may need

to drop out in the not-too-distant future. Thank you for that very interesting first set of answers.

I want to turn to the purpose and the paragraph in the report that states, "The public is also unclear about the extent to which QE is, or should be, used to finance Government borrowing. Given the UK's post-Covid fiscal position, a lack of public clarity on monetary financing could undermine the Bank of England's independence in the future".

I put it to you that there is that lack of clarity. You will know that the governor, Andrew Bailey, said in November, "We do not ... set a level of quantitative easing and asset purchases in any way related to what the government is going to borrow", yet an *FT* survey found that many investors believe that the central bank's quantitative easing programme is a "thinly veiled attempt to finance the Government's deficit to keep its borrowing costs down".

My question to you is: first, do you agree that there is a lack of clarity? Secondly, what are the consequences of that?

Melissa Davey: It is clearly on people's minds. That goes beyond the investor class and goes to the public. We show in the report that, in advance of some "Ask the Governor" events that were held online last year, the public were asked to put questions forwards, and around a fifth of those were on monetary financing. We think it is very important that the Bank gets across a message on why it is doing QE—that in conducting asset purchases it is supporting the economy and meeting its inflation target.

Of course, it is also important that it gets across the message on what it is not doing, and what its aims are not. That is about ensuring that it has clear, accessible communications on topics such as why it is not doing monetary financing.

Lord Bridges of Headley: To be clear, what you are saying, and what the report seems to imply, is that this issue can be addressed by communication. It is not an issue of the fundamental underlying purpose and intent of the policy. You are saying that it can be addressed by communication.

Melissa Davey: Both being clear on the stated objectives of QE as regards meeting the 2% inflation target and, as we say, tackling head on in accessible language what the Bank is not doing.

Q43 **Viscount Chandos:** Is the Bank doing enough to communicate with the public on those QE knowledge gaps and the potential risks arising from them?

Melissa Davey: I think that the Bank is getting better at communicating directly with the public. We have seen a number of innovations in recent years. This includes the Knowledge Bank, which explains complex economic issues in simple-to-understand language. It includes the layered *Inflation/Monetary Policy Report* and *Financial Stability Report*, which take those quite technical documents and put an easier-to-

understand summary of the main messages on top of them. Most recently, we have seen citizens' panels, where policymakers go out and talk directly to members of the public, hear their views and answer their questions.

Increasingly, the Bank has routes to communicate directly with the public, rather than relying on the press or financial market experts. We felt that the Bank had not quite got its communications on QE there yet, and that goes back to the question I was answering from Lord Bridges on monetary financing, but it is also broader than that.

This is, of course, really important, because QE is a tool that has only got bigger, broader and more persistent since it was introduced in 2009. We found that it is poorly understood and often contentious. We feel that it is very important for building public understanding and trust that the Bank provides accessible versions of its core messages on why it is doing QE, and gets into some of those topics, those knowledge gaps, those risks, those potential spillovers in its public communications.

Again, when we looked at the evidence of what people were interested in—people going to citizens' panels or going to an "Ask the Governor" event online—only about 20% of the questions could be answered in the accessible communications on the Bank's website. Those lucky enough to go to a citizens' panel or attend an "Ask the Governor" event could obviously hear answers to their questions, but that is not going to hit the majority of the population.

We thought that it was important for the Bank to develop its communications on these questions. That would include things such as monetary financing, inequality, green QE—some of the spillovers that we think people think QE might have. Somebody interested in these topics who googled them would probably find on the Bank's website a very technical document that was difficult to interact with—a working paper or a speech. If they were looking for accessible material they would probably end up looking to other sources. Those other sources may of course not have the same view on these topics as the Bank.

We thought that it was very important for the Bank to develop its communications in this area, so that people who are interested in the broader impacts on QE, on the spillovers, on the current knowledge gaps, have an easily accessible way of finding out the Bank's current views.

Viscount Chandos: Does the IEO's recommendation of a simple, story-based approach not risk oversimplifying it? Is there not evidence that the single most powerful effect that QE has had in public perception is that there is no limit to the creation of money without the risk of inflation that people had previously thought there was?

Melissa Davey: I would make two points about the oversimplifying of it. There are two parts to our recommendations. One is about getting across a simple, story-based message on what QE is intended to do. We are also suggesting having richer yet accessible communications that tackle other

questions that people may have. We are not just saying, "Make it very simple and ignore everything else". We are talking about a more rounded package.

We drew on evidence from a paper put out by ESCoE last year by Runge and Hudson on public understanding of economics and economic statistics. This showed that people found it very difficult to understand the economy. They found it a lot easier to interact through the lens of their only personal economy, rather than the national economy, which was a somewhat abstract concept. That is why we talk about messages that link QE back to people's own experiences—how it supports jobs rather than how it supports financial markets.

We have also seen evidence that the simple layered communications that the Bank is putting out improve public understanding of the messages. It is about getting some of those simple messages out there, and providing accessible material that really tackles some of the questions that people have head on, rather than relying on other people to fill in the gaps with their own views and opinions.

Viscount Chandos: Do you not risk falling into the trap, if you are trying to get it to relate to people's own experience, of promoting the misunderstanding that household economics are the same as national economics?

Melissa Davey: I think you can get around that by making it clear that it is not necessarily about your own job but about jobs in the economy as a whole. I recognise that that is a potential risk if you go too far down that route. It is about relating it to things about the economy that people find easier to relate to than something such as GDP, which might seem quite distant from their own experience.

The Chair: May I follow up on that? Perhaps I ask a daft laddie question. When you talk about communicating simple messages, do you think, for example, that that would include explaining to people the latest enormous round of QE and what the Bank's expectation is of the impact that it will have on inflation? Is that the kind of communication that you are thinking of?

Melissa Davey: Yes, that central messaging that the Bank is expanding its QE programme to lower long-term rates, to support jobs and growth, and to meet the 2% target. You can go further and talk about the sorts of magnitudes that you expect.

The Chair: Would it go on to say why it chose that number and not some other number? You would expect them to provide that kind of detail.

Melissa Davey: What we have seen with the layered monetary policy report is that, alongside the very technical document that explains a wide range of the Bank's thinking for the economics community, there is a layer on top of that that draws out some of the main messages of the report in a much more accessible way. That can include things such as

the support that the MPC currently thinks its policy choices are having on the economy. You might not go so far as to set out the cases for and against different amounts in that layered communication, but that is the sort of place where you have a route to explain the MPC's latest thinking to the public.

The Chair: I am just a simple politician, but if you are not able to explain that, I would think it was a bit odd to choose exactly the same number as the Government needed to borrow, if you were trying to maintain a position that you were meeting your inflation target and not meeting the Government's borrowing requirements.

Melissa Davey: That is probably a question for when the Bank's policymakers come to see you later in this process

The Chair: I thought that you would dodge that one.

Q44 **Lord Fox:** These questions dwell on the depth to which the Bank has engaged in the distributional aspects of QE. As your IEO report published in January puts it, "The potential distribution effects of QE are a key area of contention", and you add that the debate has proved particularly challenging. I have three connected questions, the first of which is technical and the others rather more philosophical.

Last week we heard from Positive Money that the then Governor of the Bank of England, Mark Carney, used narrow money in 2017 to show that QE did not increase inequity. Is that your understanding?

The second question is on staff working paper No. 720, which was published in 2018. This appears to be a document that people go back to when they say that the distributional effects are not inequitable. The report finds that in percentage terms they were broadly similar, without acknowledging that 10% of a small wage is not very much, and 10% of a large salary is a great deal. It does not take into consideration, as you have pointed out, state-contingent effects. Is that sufficient basis for the Bank to continue to say that there are no significant distributional effects from QE?

Finally, to play to that, you talk about the need to invest in filling in the QE knowledge gap. Do you agree that this is a big gap in QE knowledge, and investment needs to be made in the distributional aspects of it?

Melissa Davey: As regards what has been emphasised in different bank communications in this area, in the report we note that the working paper that you talk about contains a multitude of different cuts of the data in response to that question. It looks at income distribution, wealth distribution and across-the-age distribution. It shows all its results in both percentage terms and in pounds terms.

Of course, that is a working paper. It contains lots of information. The main conclusion is that by using standard measures of inequality such as the Gini coefficient, which put weight on those percentage terms, the impact of monetary policy on inequality has been small. However, that paper put out all that other information into the public domain so that

people who wanted to see it could see it. I think it was very open in that respect.

We talked to similar people to you, and we heard that those communications of the Bank that focused only on one measure had criticism from people who perhaps would use QE for different objectives from those for which the Bank has used QE.

One thing that we found with the work on inequality was that, because it took so long for the Bank's most detailed and impactful work to come out, positions on this topic had become quite entrenched. The Bank's engagement in the debate was often described to us as quite defensive.

One lesson that we drew was less about work on QE and QE knowledge gaps but more about lessons for future policy development. It was thinking proactively about the potential critiques and spillovers associated with a tool, and doing this analysis earlier, so that the Bank can get its facts on the table and engage proactively in these debates.

Lord Fox: And the question on narrow money?

Melissa Davey: The point that Positive Money makes is that the speech, which I think was drawing on the same analysis as the working paper, even though it came out earlier, focused on those standard measures of income inequality—the Gini coefficient measures that put weight on those percentage changes in inequality, rather than the pound change.

Lord Fox: Bearing in mind that the 2018 paper was pre-pandemic, do you think that there are state-contingent effects on distribution that ought to be examined, or do you think that distribution is distribution and, pandemic or no, it will be the same issue?

Melissa Davey: This is the sort of question where it would be useful for the Bank to update its analysis at some point, as well as thinking about analysis of any new tools. One point here would of course be that there is a state contingency. I should go back and note that the reason the Bank concludes that the impact on inequality is small is because, although QE supports asset prices, it also supports jobs and growth, and people's incomes are higher following QE than they would have been in its absence.

Of course, if you think that the recent round of asset purchases had a different impact on asset prices, and on incomes and jobs and output, you might get a different conclusion, but I think that it is important to try to isolate the impact of the asset purchase programme itself rather than look at necessarily the impact of Covid, say. You do not want to confuse the impact of Covid on inequality with the Bank's own actions.

Lord Fox: It is a question of whether the Bank's actions further exacerbate inequalities rather than being neutral.

Lord Skidelsky: Your evidence has been mainly about problems of communication, and the need to improve that. Of course, some obscurity

of communication may arise from the fact that you do not know what it is that you are trying to communicate: even worse, that you do not want to communicate certain things that are true. I know that in a way you did not want to answer the question earlier, but how would you communicate? Would you say that it was simply a coincidence that the asset purchases in 2020 almost exactly matched the growth of the government deficit? Would you communicate that simply as a coincidence, or would you have something else to say about it?

Melissa Davey: I am obviously not a policymaker. What I would say is that we have had a significant macroeconomic shock through the Covid crisis. I am not that surprised that in response to that shock the monetary policymakers and the fiscal authority are both supporting the economy, using their respective tools.

Lord Skidelsky: Their respective tools happen to be in very close alignment with each other.

Melissa Davey: That is one of the challenges of the fact that, since the Bank launched the QE programme in 2009, we have seen a consistent fall in global equilibrium interest rates, and, with a number of shocks to the economy, there is no further room for the Bank to loosen policy, or there is a question about the ability of the Bank to loosen policy further through interest rates, which is currently of course a live topic, so it is not surprising that the Bank has had to use its QE tool to support the economy through this very challenging period.

Q45 **Lord Haskel:** Your report states that the Bank needs to improve the way it communicates the economic rationale of QE, presumably explaining the quantity, the type, the maturity of QE, and the economic rationale of buying both government and private sector assets. Do you think that the Bank has got any better at this?

Melissa Davey: One of the challenges of QE relative to Bank Rate is that it has a number of dimensions. It is not just about the pounds-billion that you are buying. It is about the maturity of assets and the asset class—in the UK example, public or private sector assets—and it is about the pace of purchases. There is also a decision to be made on what you do when assets mature—what is your reinvestment strategy?

The design vector is quite complex. We have found that the Bank has flexed those design choices over time. It has changed the maturity of assets that it has purchased, largely for operational reasons. It added corporate bonds to the portfolio in 2016. In 2020, of course, we saw it vary the pace of purchases in response to the Covid crisis.

Using that for an example, I think that the Bank explained in the minutes its rationale for that decision very well. It explained that it was supporting the economy in a macro sense through its asset purchases, and that given dysfunction in the gilt markets at the time it was going to carry out those purchases at a faster pace, to improve market functioning. That is an example where it explained the rationale well.

We were looking for a much clearer framework that mapped the Bank's understanding and its learning about QE to how it uses the tool in practice. This goes back to what we were talking about earlier with knowledge gaps. What we would like is the more the Bank understands how its tool works, the more it is able to explain why it is taking a certain stance at a certain point in time—why it is buying pounds-billion of assets, why it is buying private sector rather than public sector assets at a point in time, and grounding that in its latest understanding.

You see that to some extent. Bank staff will always present the MPC with the latest thinking on the impact of recent rounds of purchases on GDP and inflation to help them to calibrate the next one. We thought that could become more sophisticated as the Bank advanced its learning. For example, if you put weight on one bit of the transmission mechanism relative to another, this is the impact you would expect your purchases to have, given the current state of the economy. More generally, it is about having an understanding of the state contingency of QE and how the circumstances in which you are doing it affect the impact that you expect it to have. We think that the Bank does this to some extent at the moment, but there is probably further improvement that it could make.

Lord Haskel: We have heard from other witnesses how we are all learning more about the rationale of QE. How do we compare with other central banks? How do we compare with European banks or with the Fed in America?

Melissa Davey: Obviously we talk to our counterparts at other central banks. We also ask the witnesses who we talk to for their views of how the Bank is doing relative to those other central banks. From my perspective when I am carrying out these evaluations, I am always hoping that somebody else has cracked the puzzle already, so I can just tell the Bank to copy them.

When it comes to QE, we saw in recent years that there has been more research at the ECB and the Fed than in the Bank. In some ways that is not surprising. They have a much bigger research staff, and of course the ECB started slightly later on the QE journey than the Bank and the Fed.

When we looked at other countries, it did not seem to us that there were particular further lessons the Bank should be learning. It already sees the outputs of research from those other institutions and can feed them into its own policy decisions.

When we looked at topics such as communications, it was not obvious that any of the other institutions were communicating on QE particularly better than the Bank. That was also the message we got from the people that we talked to there.

Lord King of Lothbury: Melissa, let me extend a personal welcome to the committee. It is very nice to see you rise in the Bank.

Melissa Davey: Thank you very much.

Q46 Lord King of Lothbury: May I move the discussion away from the effects of QE and more to the relationship between the Bank and the Treasury? Obviously, when interest rates are very low, it is more difficult than it used to be to distinguish between the policy instruments of the Bank on the one hand and the Treasury and the Debt Management Office on the other.

I want to ask you a general question first. Do you think there is a risk that the independence of the Bank is jeopardised by the situation in which we now find ourselves with the Bank using QE?

Melissa Davey: We looked at this question in a number of ways. We talked to the Treasury and the DMO. We think that there is a good working relationship at that level. As you know, as regards the relationship with the DMO, there were very clear boundaries. There was an agreement, for example, that the Bank buys only in the secondary market and does not buy gilts within a week of DMO issuance. We think that the working relationship between the Bank and the DMO has strengthened over time and that there is a good understanding of each other's relative roles in the market.

We looked at the relationship with the Treasury through the lens of the APF indemnity. As you very well know, the Bank conducts its QE purchases through a wholly-owned subsidiary, the asset purchase facility, and that is fully indemnified by the Treasury. That of course means that we need good, open conversations between the Bank and the Treasury, particularly on the risk profile of the APF. We thought that there was appropriate oversight and communication in that relationship, and that the institutional set-up and the design of it had been able to ensure that the MPC retained its operational independence for monetary policy.

Lord King of Lothbury: Will you say a little more about how you think that the design of the asset purchase facility helps to support the independence of the Bank and to delineate the respective responsibilities of the Bank and the Treasury?

Melissa Davey: One aspect of that is the clarity, because a lot of this is done in the public arena. The indemnity, I think, was originally agreed at £150 billion. Since then, when the Bank has wanted to expand the assets within the portfolio, either in size or the scope of assets, the governor has had to write to the Chancellor to explain why the MPC would like to do that and get the size of the indemnity increased.

Having to justify its reasons for wanting to expand the APF for monetary policy purposes, with that being seen with an open exchange of letters, and the Chancellor having to sign off that increased indemnity and therefore accept any risk that that might present, we were happy that this institutional set-up preserved the Bank's operational independence for monetary policy.

Lord King of Lothbury: The ways and means advance that was extended last April is pretty small. Nevertheless, the document accompanying it said that it would be repaid by the end of the year. It

was not repaid by the end of the calendar year. I do not know whether it will be repaid by the end of the current fiscal year, which we are not far off. Is that another area that you think somehow makes the issue of independence less clear?

Melissa Davey: That was not a topic that we considered as part of this evaluation. We were very much focused on monetary policy. That may be a topic that we come to in a future evaluation, but I would not want to comment on it at this time.

Q47 **Baroness Kingsmill:** To follow on from Lord King's probing, do you agree that there is a perception that the APF cash transfer arrangement is one arm of the state paying the other, and that the money is just going round and round? I think it is quite a difficult proposition to convey that that is not just for the benefit of government, banks and intermediaries and that it affects the economy as well. How would you counter that? Do you think that that perception actually exists?

Melissa Davey: This again goes back to the APF indemnity. That means of course that, ultimately, any profit that is earned on the APF would accrue to the Treasury and any losses would be borne by it.

To go back to one of the points that you just made, it is very important to remember that the success of QE should be judged on whether it helps the MPC meet its 2% inflation target, not on whether the APF ultimately makes a profit or a loss.

The change in the cash management of the APF was introduced in 2012. Up until that point, when the APF had received coupon payments from the Treasury on the gilts in the portfolio, it had kept them. By 2012, it had a cash balance of around £30 billion of those coupon payments. At that point, the Chancellor and the governor agreed to normalise cash management arrangements by transferring that £30 billion back to the Treasury. They agreed that from that point on there would be a net cash transfer each quarter, so that any accounting profit made on a quarter would be transferred from the APF to HMT, and any accounting loss would necessitate a transfer from HMT back to the APF.

At the time that that arrangement was put in place, there were very clear communications. The letter from the Bank and the letter from the Treasury both made it very clear that at some point in the future it was likely that transfers would go from HMT back to the APF. That was likely as interest rates rose or as the portfolio began to be unwound. The *Quarterly Bulletin* article that the Bank put out at the time made the point that, although the size and timing of any reversal of flows was very uncertain, they were highly likely, and they could well be large.

Since 2012, the portfolio has only got bigger and interest rates have fallen further. That means that those cash transfers have only gone in one direction—from the APF to the Treasury. By October last year they totalled £110 billion.

The message that we drew out in the report was that it is very important that the Bank continues to focus awareness on this topic because it is still likely that those flows will reverse at some point, as interest rates rise or the portfolio begins to be unwound.

We were happy that that was being discussed on a regular basis at a working level between the Bank and the Treasury—that there was an understanding—and that those messages were being cascaded up to the senior stakeholders. We felt that you probably cannot communicate enough on it in making it clear that it is likely to change at some point in the future. We thought that it was useful for the Bank to continue to remind people of this in its external communications. Dave Ramsden talked about it in a speech that he gave last week.

We also thought that it might be useful for the Bank to republish a spreadsheet that it included alongside its 2013 *Quarterly Bulletin* article, allowing people to type in their own view of the path of interest rates and the future asset purchases or sales, and see the implication for those cash flows.

Our main recommendation was about building understanding of these cash flows and ensuring that a reversal in flows, which is highly likely when it occurs, does not take anyone by surprise and cause the Bank difficulty in meeting the need either to unwind the portfolio or to continue to manage it as interest rates rise.

Baroness Kingsmill: It is a very tricky area, is it not, because it is full of unknowns about when it will unwind and so on? The perception at the moment is that it will not be any time soon.

Melissa Davey: Yes, that is why a tool that allowed people to put in different assumptions would be useful. It is also why we make the point that this should remain in constant conversation even when it is not necessarily going to happen tomorrow. If you do not talk about it for three years, and suddenly those flows start to reverse, that is obviously a harder situation to manage than something that you have been talking about every quarter.

The Chair: On the communications point, I wonder how many people know about this £100 billion. It is a huge sum. It was certainly news to me and I think it would be news to most members of the public.

Q48 **Baroness Kramer:** I have a slight change in direction to accountability. This is a very current topic, with the Financial Services Bill going through Parliament—this is one of the most controversial parts of it—and the financial services future regulatory framework review, where one part of the consultation has just completed but there is more to come. Through which channels, whether we are looking internally or externally, is the Bank accountable for its QE programme, and to whom would you say it is accountable?

Melissa Davey: Internally, there are a number of channels. There is the Bank of England's Court of Directors, or its board. The Court has

responsibility for monitoring the performance of the Bank in respect of its statutory objectives, of which monetary policy—and QE—is one. The Court has a number of ways of monitoring the QE programme and the Bank, including going along to MPC meetings and an annual report that it receives on the support that policymakers get from staff.

An important way in which the court is holding the Bank to account on its QE programme is by asking us to carry out this evaluation. It is also important to note that our involvement in accountability does not stop when we publish an evaluation. We also have a follow-up framework. I will be following the implementation of all the recommendations in this report on a regular basis. When we think all of them have been fully implemented, we will go back to court with a report on how they have been implemented and the impact that we think they have had. That is one important part of accountability inside the Bank.

Baroness Kramer: What about externally?

Melissa Davey: I was just going to turn to outside the Bank. You ask who the Bank is accountable to. It is obviously accountable to Parliament, and, most importantly, it is accountable to the people of the UK. In that external accountability, the Bank's communications play a key role. Regular communications are put out to set out the Bank's view of QE. That would involve *Quarterly Bulletin* articles, academic papers and the like.

There are, most importantly, the communications by the MPC: the MPC minutes, where it explains its decisions; the *Monetary Policy Report*, where it can get into more detail on the reasons for those decisions and how it think its tools are supporting the economy; and, of course, individual MPC members' speeches and testimony to Parliament.

An important part here is that, although those communications are outward communications, the dialogue is also important. That is why inquiries such as this are really important, so you get to hear the views of a number of people, both inside and outside the Bank, and get to challenge the policymakers themselves on their decisions.

Of course, there is also the regular interrogation of the MPC on its decisions, both in the press conference held after the *Monetary Policy Report*, and the sessions held in the other place with the governor and MPC members after those reports.

There are a number of ways in which the Bank is accountable. As we discussed earlier, there are certainly ways in which the Bank can improve its communications in this area, and really help to get its messages across to as broad an audience as possible as regards helping that public accountability.

We highlight a number of times in our report that when QE was introduced it was seen as a transient, unconventional tool to provide temporary support through the crisis. Since then we have seen it go in

only one direction. With the financial crisis having a longer impact than expected, global interest rates continuing to fall, and a number of further shocks hitting the UK economy, QE has only got bigger, broader and more persistent than originally expected, but it remains a poorly understood and contentious tool. It is really important for the Bank to continue to build public understanding and trust in this tool, which is likely to play a part of the monetary policy toolkit for some time to come.

Baroness Kramer: Do you see any distinction between communication and accountability? Perhaps you could do it in the context of the corporate bond purchasing scheme, where the Bank could play a much more overt industrial role, whether in levelling up, developing infrastructure or tackling climate change. I rather have the sense that communication is accountability from your perspective. Will you address those two sets of issues?

Melissa Davey: The corporate bond scheme is an interesting one, because the Bank very carefully set it up to meet its macro remit. It focuses on investment-grade—high-quality—bonds of sterling assets in private non-financial companies that make a material contribution to the UK economy, but within that it very much takes a sector-neutral approach and has purchases evenly across that eligible universe. That was consistent with its macro remit.

The criticisms of that scheme have tended to be that the Bank should have instead tilted its purchases towards one sector or another. For example, in the report we mainly talk about this in the context of the green QE debate, where some people want the Bank to be purchasing more green assets, or note that the Bank's other communications on risk management suggest that it should be skewing its purchases away from carbon-intensive assets for prudent financial risk management reasons.

We also heard the other side. Given how small the corporate bond scheme is—it is only £20 billion—the Bank making any changes to how it targets those purchases is unlikely to have a macro impact in the economics of moving to a carbon-neutral economy.

Of course, the point that the Bank's remit is a macro one, and tilting towards a certain sort of assets, would not be consistent with the remit as currently given to it by the Chancellor.

This is a live question. I think that the Governor has said that the Bank is currently working on it, but any change that it would make to that portfolio would have to be done in the context of the remit given to it by the Government.

The Chair: Are you done, Baroness Kramer?

Baroness Kramer: I had another question that you may be referring to, but I thought that it had been reasonably answered earlier. I am very curious about whether the report would have been different had it been written in today's context rather than looking back at the first rounds of

QE, but I think that was answered by responses to both Lord Fox and Lord Skidelsky.

The Chair: Thank you so much for giving evidence to us. You have given very clear answers and dealt with our questions. May I ask a slightly cheeky question? You have absolutely emphasised the importance of communication. I just wonder, with no disrespect at all to your excellent report, whether all this stuff is rather obvious, and why has the Bank not been doing it anyway?

Melissa Davey: One point here is a question of priorities. The advantage of an evaluation such as ours is that it gives you a chance to step back and look at these questions in the round, and realise some of those gaps that may have built up over the years in your communications, and start to think about how you want to deal with them. It is helpful for us to come along and provide that external perspective that can say, "Hang on a minute, there are all these questions that you are not really answering as regards your accessible communications, so even though you have made really good progress in, say, layering the *Monetary Policy Report*, you have not really tackled these more contentious questions in your communication, and it would really help if you were able to step back and deal with those as well". Hopefully, bringing that perspective slightly outside the day-to-day policy round that the Bank staff and policymakers are always in helps in recognising what the gaps are, and how you can fill them.

The Chair: On that note, I thank you very much on behalf of the Committee. You are welcome to stay for our second session. We are extremely grateful to you for taking time and for giving such clear testimony to the committee.