Treasury Committee

Oral evidence: February 2021 Monetary Policy Report, HC 1222

Wednesday 24 February 2021

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Harriett Baldwin; Anthony Browne; Dame Angela Eagle; Mike Hill; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 70

Witnesses

I: Andrew Bailey, Governor, Bank of England; Ben Broadbent, Deputy Governor, Monetary Policy, Bank of England; Jonathan Haskel, External Member, Monetary Policy Committee, Bank of England; and Dr Gertjan Vlieghe, External Member, Monetary Policy Committee, Bank of England.

Written evidence from witnesses:

Professor Jonathan Haskel, Report to the Treasury Committee [MPR0005]

Ben Broadbent, Report to the Treasury Committee [MPR0006]

Examination of Witnesses

Witnesses: Andrew Bailey, Ben Broadbent, Jonathan Haskel and Dr Gertjan Vlieghe.

Q1 **Chair:** Good afternoon, and welcome to the Treasury Select Committee witness session on the February 2021 *Monetary Policy Report*. I am delighted to be joined by four witnesses this afternoon. I ask them very briefly to introduce themselves to the Committee.

Andrew Bailey: I am Andrew Bailey, Governor of the Bank of England.

Ben Broadbent: I am Ben Broadbent, Deputy Governor for monetary policy.

Jonathan Haskel: Good afternoon, everybody. I am Jonathan Haskel from Imperial College, and an external member of the Monetary Policy Committee.

Dr Vlieghe: I am Gertjan Vlieghe, an external member of the Monetary Policy Committee.

Q2 **Chair:** Welcome, everybody, and thank you very much for coming today to appear before the Committee. As I think you all know, because you are all old hands at the Treasury Select Committee, questions will generally be directed to one or more of the panel, but if you want to come in on any particular point and have not been invited to do so, just raise your hand and I will endeavour to bring you in.

Before we kick off on the main business we are focusing on today, which is the *Monetary Policy Report*, Andrew, I know you have a statement that you would like to make to the Committee. I would be grateful if we could hear that now.

Andrew Bailey: I do not want to take up any great amount of time, but I just wanted to touch on the whole question of equivalence and financial services. There is a lot of talk around about it at the moment, and I am conscious that we may not have another hearing for a while. It is quite a live issue, particularly this week. I want to put a bit of context on to what is going on and what is being reported at the moment.

Just to start with what equivalence is, taken literally it is a process by which a country, or in this case the EU, can tell and require its own citizens not to do something in another country, the UK in this context, and obviously there is a reverse process involving the UK. It does not in any sense mandate what the rest of the world should do. That is relevant.

Let me take the example of clearing, particularly euro derivative clearing, which is a very large activity and a very UK-based activity at the moment. At the moment, as I am sure you know, there is temporary equivalence in clearing, which lasts for 18 months. Let us assume, for a moment, that temporary equivalence comes to an end and nothing else happens. The consequence of requiring the move of euro derivative clearing to the EU from the UK would be to require the movement of about 25% of euro derivative clearing. The numbers are sometimes slightly staggering and eyewatering. To give you an example, in LCH, the main clearing house, the outstanding euro derivative clearing is currently around €83.5 trillion, which is about 27% of total clearing in LCH.

The reason for making this point is that moving 25% of euro clearing, or requiring it to move, does not, as I was saying earlier, mean that the other 75% has to move. The other 75%, we have to assume, was chosen to clear in London because there are good reasons in terms of efficiency and the services offered. The debate that is now building up—we have seen it this week—is that if only 25% moves, it is not really very viable. In other words, the euro area or the EU takes something but it does not take a piece that is really viable for its own industry to conduct in the EU. There are quite strong arguments coming out of the EU financial sector on that.

The question then becomes not a question about equivalence, but a question about how it can get the other 75%, bearing in mind, as I said earlier, that equivalence does not get the other 75%. To get the other 75% by fiat would require something very controversial, such as an attempt at extraterritorial legislation or an attempt to force or cajole banks and dealers by saying, "There will be some other penalty for you unless you move this clearing activity into the euro area."

To my mind, that is what we are seeing, particularly this week. There are some papers circulating around, coming out of the European banks, that have been reported on. That seems to be where the debate is heading. I am not surprised by this. In many ways this debate is not about equivalence; it is about something that, for quite a long time now, has been called location policy. It goes back to at least 1999, in my experience, when the euro area was created and there was a desire to have euro business concentrated in the euro area. It never really came to anything. Some of you may remember there was an attempt at a legal action that went on for some years to get euro clearing into the euro area from the UK. It did not work. Brexit has obviously been the stimulus to revise this debate. I say that in a non-judgmental way; I never make a judgment on Brexit.

The reason I wanted to make this point, because it is in some of the news at the moment and is growing, is because in that case the debate is not really about equivalence, and the whole debate about what our future regulation should be and whether it is aligned with the EU is something of a sideshow. Indeed, it is not relevant to location policy in that sense, because it would require, as I said earlier, other things to attempt to be done to get 75% to transfer out. I have to say to you, quite bluntly, that that would be highly controversial. It would be something that we would want to and have to resist very firmly.

Thank you for giving me the time, Chair. I just wanted to put you in the picture on that, because where this debate appears to be really heading to at the moment is not just a debate about equivalence. In fact, it is probably not even primarily a debate about equivalence, if indeed that is the intended outcome.

Q3 **Chair:** Thank you very much indeed for that. It is very good of you to give us that statement at the beginning of this session. It is a very important and very live issue that the Committee is looking at very closely. Could I have a quick follow-up questions on that? There is this 75%, which we might term as being within this location policy area rather than being related directly to equivalence. In your judgment, how difficult is it for the EU to use extraterritorial legislation or cajoling banks and dealers, as you put it, into trying to get hold of that 75%? What would the Government's options be were that to start to become problematic, and are you having discussions with Ministers at the moment on those issues?

Andrew Bailey: The issue of location policy is not a new one in that sense, so we have been aware of it. What has been notable in the last few days is how it seems to be coming to the surface. The timing is not that surprising, given where we are. It would be very controversial, because legislating extraterritorially is controversial anyway, and of dubious legality, frankly. Therefore, probably the more likely way to do it would be the second way, which in itself is controversial. That is to say to firms, "You need to move this business into our area. If you do not, we will think of something else to do." That would be very controversial. Frankly, it would be a very serious escalation of the issue. I am obviously not going to say how the Government would react to that, because that is for the Government to think about. We will work very closely with them on this, but it would be a very serious escalation of the issue.

Q4 **Chair:** Can I come back to the 25%? You have made the statement that in your view it would not be viable for the EU to have that 25%. It is a large market. On what basis would one argue that it is not worth having the 25%?

Andrew Bailey: Particularly in an activity like clearing, which is probably the best example, the efficiency really comes from having a very big pool of derivatives that can be netted and cleared down. By splitting that pool up, the whole process becomes less efficient. That is a fragmentation to start with. Having the smaller part of the pool would be even less efficient. I kept it deliberately simple. You could take it on and say the clearing houses also involve a certain amount of cross-currency netting to go on, and that would break down as well. There are strong reasons why there is a big agglomeration of something like clearing. It is not a surprise that clearing tends to concentrate in particular centres on particular clearing houses. To break that down would increase cost, there is no question about it.

Q5 **Chair:** Would it be your view that, if the EU were to go down this route and make these requirements of banks and of the sector in order to gain this business, it could have financial stability implications in terms of banks being pushed and pulled by regulatory authorities in different directions?

Andrew Bailey: That is a very good question. It is certainly something we would be concerned about as the financial stability authority. Clearing has come far more into the foreground as a financial stability tool since the financial crisis. A lot more instruments—particularly derivative instruments of the sort we are now talking about—are cleared now than were before the crisis, because one of the weaknesses that was identified in the financial crisis was the prevalence of over-the-counter arrangements that were not cleared. That brought the clearing houses much more into the centre of the financial stability world. We spend a lot of time on them, as do the EU authorities and the US authorities. You are right that any erosion of the stability of the clearing system—it is a global system, really—would be a concern.

Q6 **Chair:** That is helpful. Finally, we are obviously all aware that both sides are working towards the memorandum of understanding that will hopefully be concluded next month. You may or may not want to say anything on it, which is fine, but is there anything you can share with the Committee as to how you think those discussions are going? Are we going to get anywhere at all? There seems to be general pessimism on that front at the moment.

Andrew Bailey: The Treasury is the lead on it. We are supporting Treasury very actively. It will have all the support it needs from us, and is getting it. It is a statement of intent to work together in the future. That is important, because we work together in global fora. As has been pretty universally said, it is important to bear in mind that it is not automatically going to lead to equivalence.

Q7 **Chair:** Once again, thank you for coming to the Committee with that; it is extremely helpful. Could I now turn to the MPC and the report? Andrew, you said in November that you could see some light at the end of the tunnel. I think this was particularly in relation to the vaccine rollout. After the news about vaccines being approved, et cetera, how bright is that light now? Are we to be expecting much better things than we had originally thought? How do you analyse that?

Andrew Bailey: It has been quite an up-and-down-and-up story since we were last in one of these sessions. To walk through that period for a moment, interestingly, the fourth quarter of last year—the numbers are now getting more complete—actually turned out to be quite a bit stronger than we thought it would be in terms of economic activity. That is interesting, because one of the things we would take from that, although you have to be careful about comparing the lockdowns because they have had different scopes to them, is that the impact of each lockdown on economic activity has attenuated. Another way of putting it is that we have all become more adept at finding ways to do things during lockdowns, online shopping being the primary, obvious case in point. The latest retail sales figures show that the share has gone up further. The fourth quarter was actually stronger than we thought it would be. That was the first piece of news.

The second piece of news was obviously the return of Covid, very sadly, and then the new lockdown, the one we are in at the moment. The first quarter is going to be considerably more negative than we expected it to be in November, albeit starting from a somewhat higher level because of the outcome in the fourth quarter. Even then, I would say the evidence so far in terms of the impact of the lockdown we are in at the moment, from the activity numbers and talking to businesses as we do, puts it midway between the other two lockdowns, but the impact is more attenuated than the first lockdown, when we had this precipitous drop in economic activity. We are starting, however, from a lower point in Q1 than we thought we were in November. That is important.

However, the story on the vaccine programme is good. The Covid news is good in terms of the numbers we are seeing. We now have the Prime Minister's announcement as well. Broadly, what the forecast embodies is that, starting from a lower level at the end of this quarter, we assumed that the economy would open up during the second and third quarters, and that by roughly the early part of next year we would be back to where we were pre-Covid, about a year ago, but because we were starting from a lower level we have a somewhat higher growth rate during the rest of this year.

Just to finish up, the Prime Minister's announcement is broadly consistent with our forecast. What I mean by that is in our forecasts we have activity returning over the second and third quarters. The announcement would suggest that quite a lot of the lifting of measures will happen in the second quarter, but it is reasonable to think, as we did, that the follow-through impact of that in terms of people's reaction to it—the evidence we are getting on the vaccination programme is important there as well—will lead to a lifting of activity starting in the second quarter and going through into the third quarter. Broadly, that announcement is consistent with what we had in the forecast.

Q8 **Chair:** Gertjan, back in September your view was that the risks on the forecasts were to the downside. Do you have a comment in a similar vein for this set of forecasts? Do you think we are looking at the central case? Where do you think the risk lies at the moment?

Dr Vlieghe: It is quite a different outlook now than in September. The key difference is that in September we did not even know if we were going to have a vaccine, and we certainly did not know when we were going to have a vaccine. We had to take very seriously the possibility that it would take quite some time. The point I made at the time is that we cannot possibly hope for a full economic recovery without a vaccine, because then every time you open the economy up, the virus starts spreading again and it inevitably leads to another lockdown.

Since we now have the vaccine it is quite different. We are now looking at the prospect of reaching the point where there are no more serious, direct impacts of Covid via health restrictions and social distancing preventing people from doing certain things. We can now say that with a lot more confidence. There is still some risk. There is the risk that the variants will cause a delay in the vaccination programme or that some of the variants will turn out to make the vaccine somewhat less effective, but we are mostly talking about a delay relative to the trajectory that we have in mind.

The thing that is really uncertain is, even once all these health restrictions and voluntary social distancing are removed, does the economy by itself, without any additional measures, fully return to its pre-Covid trajectory? Does the labour market really fully return to full employment, or would it need some additional help? That is a much more difficult judgment. In that respect, the risks are still slightly tilted to the downside, but it is a very different reason than why they were tilted to the downside back in September.

Q9 **Harriett Baldwin:** I am going to turn to inflation and spare capacity. I want to talk to the Deputy Governor, Ben Broadbent; if others want to come in, feel free to do so. Since we now have the free trade agreement with the EU, has the Monetary Policy Committee been able to quantify whether that has got any inflationary or capacity impacts?

Ben Broadbent: Not so much directly. We anticipated that there would certainly be frictions at the border, even in the event of a deal—temporary frictions, I have to say, because we thought that firms would learn what needed to be done over time. We have seen some evidence of that.

We do not have much evidence on prices directly, nor do we anticipate a very strong effect. The most obvious effect would be, to the extent that the foreign exchange market was attaching some weight to the possibility of no deal—and that was true, if only a small weight before December—then one would have expected, as indeed we saw, sterling to appreciate because of the deal. All else equal, one would expect that to have some depressive effects on inflation. It is hard to say whether those frictions are having the opposite effect, because prices are subject to all sorts of influences. We did not anticipate or have evidence of anything like that. The main effect has probably been on the currency.

Q10 **Harriett Baldwin:** There is a level of uncertainty that has been removed. With the Prime Minister's roadmap on Monday, there is also a far clearer timetable in terms of the reopening of capacity in the economy. I want to ask you, Deputy Governor, about yesterday's employment report, which showed that construction employment is back to pre-pandemic levels. Average earnings growth was quite significant, around the 4% level. Was that a surprise to you in terms of the strength of some of those measures in yesterday's employment report, given how stringent the lockdowns were in the fourth quarter?

Ben Broadbent: No. I may take some time with the answer because the numbers are quite fiddly. One of the very important things to understand about this extraordinary episode is how divergent the effects have been on different parts of the economy. That has had effects on both the numbers you quote. It has been far more severe, not surprisingly, in the areas of the economy that deliver consumer services, particularly in what we have called in the report "social consumption," which are things that involve getting together. If you look at employment in arts, entertainment, catering and so forth, those are still materially down, and there are a lot of people in those sectors still on furlough. There are other areas of the economy and spending and demand that, if they have been affected at all, have been barely affected. Employment and prices in those sectors have been materially stronger.

Q11 **Harriett Baldwin:** If you now combine that in the forward look with the certainty that we now have in the roadmap for those sectors that were worst affected, does that give you concern vis-à-vis the 4 February report in terms of the risks to inflation and capacity in the economy as you look ahead? In that report you had the economy returning to capacity by the end of this year.

Ben Broadbent: Yes. There are two very big moving parts here. Quite when it returns to capacity is highly uncertain. On the one hand, demand and the overall level of economic activity is still materially below where we were before the pandemic. In the forecast it is a year hence that we get back to those levels. The reason we have not seen a huge opening of spare capacity—we have seen some, but nothing like what you would have expected given that decline in aggregate GDP—is the furlough scheme, essentially. That is the biggest single reason. One way of putting it is that it has temporarily withdrawn supply, in the form of labour supply, from the economy. As we open up, that supply comes back on stream.

A moment ago Jan described that it is still very uncertain which of those wins. In the forecast we had the furlough scheme ending at the end of April, which was Government policy at the time, and still is, formally. In the forecast, as we have had in successive forecasts, we have had a rise of unemployment as the scheme comes to an end. In the forecast, spare capacity in aggregate rewidens in the short term before it then closes, but given that that judgment is the balance of two big moving parts it is necessarily uncertain.

Let me finish with one thing about earnings. The big divergence and the effects of this on the economy have also affected those average earnings numbers. Those numbers are not the growth rate of any single or representative person. What they are is simply the growth in a firm's total wages, less the growth in its employment. On average it is the lower-paid who have lost their jobs—unfortunately, that is the case—so you will see that having a positive effect on AWE growth. There may have been some increase in growth independently of that, but a lot of what we have seen are these so-called compositional effects.

Q12 **Harriett Baldwin:** I did pick that up in the report. If you look at how economists view the risks around your inflation forecast, a recent survey for the Centre for Macroeconomics showed that a fifth of them expect you to overshoot the target over the next decade, and another fifth expect you to be unable to stop the economy overshooting the inflation target. Why do you think these economists doubt your willingness or ability to meet the inflation target over the next decade?

Ben Broadbent: By my count that leave three-fifths who do not believe either of those things.

Harriett Baldwin: It was quite skewed.

Ben Broadbent: I am sure you can find people on both sides. Our remit says that our primary objective is inflation. It is one all the MPC takes extremely seriously. We have to meet that target at all times. If you look through the history of inflation-targeting, that has certainly been the case. The last quarter-century has seen more stable inflation than in any quarter-century in an 800-year series for inflation estimates we have at the Bank. We will continue to take that responsibility extremely seriously. We assiduously look at the many measures and inflation expectations we have from those in financial markets. The longer-standing surveys from several sources do not point to an expectation, on average, that inflation will exceed the target. Indeed, they have been remarkably stable, which is reassuring. We will continue to watch them very carefully, but I do not see any evidence across the piece that inflation expectations have moved to levels that would worry us with regards to the inflation target.

Dr Vlieghe: As Ben said, we are constantly looking at a wide range of evidence on inflation expectations: surveys of households, surveys of firms, what financial market participants think, what financial market participants price in financial instruments. This is one survey of 27 economics professors, six of whom said that they thought inflation over the next decade would overshoot and we would allow it to overshoot. It is interesting; you can read the comments in the survey about why they thought that and how confident they were; most of them were not confident of that at all. Highlighting this survey among the vast range of evidence that we have from long-running surveys that are very carefully designed with hundreds, and on occasion thousands, of participants is quite a different thing.

Q13 **Harriett Baldwin:** I do worry. Brexit is now much clearer and we have this roadmap in terms of an irreversible-looking timetable; there is a lot more certainty. I am personally concerned about some of the potential for us to be surprised to the upside on inflation, but obviously I am not the expert that you are. I am just asking about it. I also wanted to turn to next week's Budget. There is obviously a lot of fiscal stimulus in the economy, as well as a lot of monetary stimulus. Do you think that the amount of fiscal stimulus currently in the economy needs to be increased in order for the economy to recover to its core growth level?

Ben Broadbent: We take Government policy as given. It is not for us to comment on it. Fiscal policy is obviously an important ingredient in our forecast for demand, and, because of that, for inflation. It was the case in the February MPR that, given all the other assumptions we were making and given the asset prices that went into it, I suppose you could say it was, but all those things can change from one quarter to the next. We do not have a view as to what should happen; we just take that policy announcement as given. We will look closely at next week's Budget and think about the implications of it in the next round in May, along with all the other developments for inflation and our own policy.

Q14 **Julie Marson:** I would like to turn to the accumulation of household savings and the outlook for spending. Ben, we are now well into the vaccine rollout. As we know, we have had the Prime Minister's announcement. What is your interpretation of the evidence that we have had on how households are spending or how they are responding to the vaccine rollout? Are they increasingly optimistic, and is that having an effect on their spending?

Ben Broadbent: It is pretty early days. We saw an increase in consumer confidence in the most recent monthly survey, but these things move up and down anyway, so we would need to see more of that over time. As the Governor explained, our forecast has a pretty material increase in consumer spending as restrictions are gradually lifted. One would expect that to go hand in hand with increasing consumer confidence. That said, it also has a rise in unemployment in the near term, which will temper the speed of the bounce-back.

On the question of accumulated savings—I am sure others may want to comment on this—we thought hard about that. In the forecast we have an assumption that around 5% of those accumulated savings get spent. That is in line with average estimates for the effect of higher wealth on consumer spending. Clearly there are risks on either side of that. A lot of these savings are in the form of liquid assets and deposits, so maybe they could be spent quickly. Equally, they are skewed towards people who are better off, the old, who already have savings and may be less inclined than the average person to spend out of accumulated assets. We will follow these things as they go along, but it is clearly the case already in our forecast that we have a very material fall in saving rates with increasing consumption as restrictions are lifted through the course of this year.

Q15 **Julie Marson:** For the benefit of the Committee and those watching, could you explain why the vaccine rollout could lead to households delaying spending for the time being?

Ben Broadbent: Against the backdrop, relative to a forecast that has pretty rapid recovery, the main downside risk is the risk that unemployment materially goes up in the spring and summer of this year, which is also a feature of the forecast. The evidence from last summer, when the furlough scheme was still in place, was that, as those restrictions are lifted, you see a pretty immediate bounce in spending. Indeed, what we saw, not just in this country but in every other advanced economy in the summer of last year when there was that big lull and retreat in cases and infection rates, and restrictions were lifted, is that recovery and consumption was, across the board, stronger than we, our peers and just about every other economic forecaster had anticipated at the outset. Our forecast builds that in, but clearly there are risks on both sides of that central view.

Jonathan Haskel: To add a little colour to what Ben was saying, we base our estimates about the consumption response to this involuntary saving on a wide range of evidence, some of which is econometric, but some of which is just based on the fact that you can go and ask people. If you ask people how they would respond, in the NMG survey 70% of people say they plan to continue to hold their savings in their bank accounts and not spend. Just to amplify what Ben was saying, we look at a large range of evidence on this, including those attitudinal types of surveys as well.

Q16 **Julie Marson:** I am going to go back to something that Ben was saying about the 5% assumptions you have made. You have quite rightly said that here are risks in any assumption. How confident would you be about that 5%? What are the implications if it is more than that, as it could be?

Ben Broadbent: The implications are quite significant because it is a reasonably significant amount of money. You would not need to tweak that number by much to see a faster recovery. I do not know how large the implication would be for the medium term. Once you are looking forward a year or two, it is probably less significant, and what will matter more is simply the prevailing level of household income and the more normal influences on spending. Certainly through the course of this year, a tweak either way could have quite a material effect on how fast things come back.

Notwithstanding Jonathan’s point—he is right—we looked at as wide a range of evidence as we could, and in none of that extensive evidence is there a history of a pandemic and severe restrictions in recovery from those. I certainly put at least as much weight on what happened last summer as I do on that other evidence. We have the balance about right. If you are in a place where you think the risks are equal on both sides, that is as much as one can do.

Q17 **Julie Marson:** Can I ask you about the economic implications of the unequal potential rise in spending? For instance, low-income households are more likely to have seen a fall in their savings, yet they are more likely to have the propensity to spend. What are the implications of that divergence?

Ben Broadbent: As I say, that would lead you to aim for a lower number than we assumed. If you think of this purely as an increase in aggregate wealth, in the past the evidence for those increases has come from a more even increase than this one, and therefore recognising that it is skewed towards people who may be less inclined on average to spend that increase would cause you to lower that number. There are risks in the other direction, not least that all these are pretty liquid assets; the measures we have of household wealth that feed into these econometric estimates would include an increase in the value of your pension, say. For many people that would not have much bearing on their immediate propensity to spend. As I say, there are risks in both directions. The skew is certainly noticeable; in and of itself, it would tend to make you want to aim for a slightly lower number than the one we have assumed.

Q18 **Chair:** In the event that these extra savings are not released back into the economy at what we might call the optimal level to ensure growth, what tools would the Government naturally look to in order to try to make that happen? Are we looking at temporary VAT cuts? What sort of things would come to mind?

Ben Broadbent: It is not for me to comment on what the Government should do, nor will I even say whether it is right or wrong that people should. We are much more interested in what will happen.

Q19 **Chair:** I did say "what sort of tools might." I am not looking for advice; I just wondered what economists might naturally be thinking of in that sense.

Ben Broadbent: Some of those have already been put in place. Stepping back, I am not sure it is right to think that this should or should not happen. It will to some degree, but the Government have clearly taken many measures in the past that are designed to support or retard the growth of consumer spending. It is not for me to comment on.

Q20 **Rushanara Ali:** I am going to return to unemployment. I know you have touched on it already. Looking at the overall figures, the MPC's projections are that unemployment peaks at 7.75% in the middle of 2021, falling gradually to 4.5% in the first quarter of 2024. Looking at the data that came out yesterday, we got a flavour of the impact on certain groups. Women are faring worse now. Ethnic minorities are twice as likely to have experienced unemployment in the last year. Some 420,000 young people were unemployed in the last year, on top of the 600,000, and I expect there will be regional variations. I will start with Ben Broadbent and then go on to the Governor. Could you talk through how you see things emerging? You mentioned the vaccine in the forthcoming period. What can the Government and the Bank of England do in terms of limiting the scarring effects in certain regions, but also in those particular groups that have been hit very hard?

Ben Broadbent: It is unfortunately always the case, even in a normal downturn, to the extent that such a thing exists, that when unemployment goes up, it tends to be the less well paid, the young, who more often lose their jobs. Recessions are regressive. As I said a moment ago, regrettably, that has been even more the case during this episode because of the nature of the jobs in the areas of the economy that have been hardest hit. Consumer services, leisure, hotels, restaurants and shops tend to have less well paid or marginally attached jobs. Part of the task of stabilising inflation is to stabilise swings in demand and to minimise swings in unemployment. That is not to say they never happen, but under inflation-targeting they have been milder and less acute, and that is an absolutely key judgment—the path of unemployment—as to how we set monetary policy. Indeed, it is the fact that we anticipated and continue to anticipate that unemployment will go up that explains, in large part, why we have used monetary policy in the way that we have.

Q21 **Rushanara Ali:** Can I push you on regional variations? That is another dimension to unemployment that we have seen in the 1980s and other periods after previous recessions. You would say the same, would you?

Ben Broadbent: I do not know as compared with the 1980s. The 1980s was extraordinary in its regional concentration.

Q22 **Rushanara Ali:** Can you comment on the regional variations? What are you seeing? We have had these debates in this Committee in previously Parliaments, about the fact that macroeconomic policy does not dig deep enough, for understandable reasons, into regional variations, into the scarring effects on certain communities and certain parts of the country, as well as certain demographics. We have never really got to a satisfactory conclusion about what central banks can do to blunt the impact. This crisis has hurt these groups even more. It is quite unsatisfactory for the country to hear, "Yes, this is a pattern." What do we do about it? Is there more that our central bank can do?

Ben Broadbent: Let me begin with a slightly technical point. We have one instrument of policy. That means we can hit one objective, not many objectives, or at least we cannot hit them all equally well if we are given more than one. It is the case that, in seeking to stabilise inflation, what we effectively do is to seek to stabilise spare capacity and to minimise swings in unemployment. That goes in the direction of minimising these regressive job losses. We entirely recognise that has been the case. It is extremely regressive. It has been the case in every single country in 2020 thanks to the nature of the pandemic and what it has done to certain areas of the economy.

The best thing we can do is what we are tasked to do, which is to minimise swings in spare capacity, including unemployment, in order to meet inflation. Although it is not directly our objective to target particular areas of employment, whether regionally or by other cuts, the effect of what we do is to minimise those swings, and that is what we continue to be focused on. As I said earlier, that is the reason why we have already eased monetary policy, in the unfortunate expectation that we will see further increases in unemployment.

Q23 **Rushanara Ali:** Governor, can I ask you to reflect on some of the things you said last September about furloughing? When we ease restrictions the Government will be removing the furlough scheme. In light of these variations in some groups, how do you think the Government should exit the furlough scheme, given certain sectors have been hit hard? What support is needed so we do not find ourselves in a situation where we get a cliff-edge in terms of unemployment levels because we have millions of people who are still on furlough? The transition towards opening up is going to be a tough one for businesses and their employees.

Andrew Bailey: As we have said a few times already this afternoon, obviously we are not going to comment on what should be in the Budget. That is strictly for the Chancellor. It is a really good question, so let me try to lift it to a somewhat higher level. The UK is much like other economies in this respect. What we have been going through, and are still in, is what I would call the first phase, which is a phase of widespread support of economic policy for dealing with the pandemic itself. That is entirely appropriate, although the policy mix has differed at a level of detail across countries. Some have gone for one mix of support policies and others have gone for another mix, but broadly that is what we have all been doing and it is right. That is still continuing.

As you say—fingers crossed—the signs are that we are going to come out of that. There will come a point, and I am not going to speculate on when that point is because it is strictly for the Chancellor, where the logic of that approach indicates that the measures should become more targeted and more supportive to the very good point you make about the impact of this shock on communities and the uneven impact in terms of age, income, gender and ethnicity. It is all the things that we least wanted to observe and experience. It needs to become more targeted.

You raised the 1980s, which is very interesting. I am more optimistic on that front, because the 1980s was a period where the economy went through a very wrenching structural change—I am talking about economics, not politics—away from heavy industry and mining, over time, to the economy we have today. I do not think we will go through that in the post-Covid period; by the way, that is why we have a relatively low number for scarring, as you said, in our forecast. It is a fairly small number by comparison with the sorts of numbers that you can get by looking at the 1980s.

Q24 **Rushanara Ali:** Just to probe you on that, I appreciate the analysis you are giving but the fundamentals are that those groups that were hurt in the 1980s—the demographics that found themselves, frankly, stuffed in the 1980s—are not changing. It is regional issues, regional variations and those at the bottom end of society. There is a constant there, and in fact this pandemic is exacerbating it. Some groups end up being hit hard, as Mr Broadbent just pointed out. The data shows that, in constituencies like mine, poorer people fare worse in every indicator; black and minority groups are dying in larger numbers.

Andrew Bailey: That is terrible.

Q25 **Rushanara Ali:** Some 420,000 youth unemployment in a year is still a significant number. It is a lot of lives. How do we move past that and, looking to the future, how do we ensure that we address it? I am not saying you can do it on your own, given your limited number of instruments. Are we saying it has to be Government only, beyond what you are doing? What are the things that are going to make a big difference?

Andrew Bailey: I was seeking to agree with you in a big-picture sense. There will come a point where we need to shift from the large-scale support phase, of which, by the way, the furlough scheme has been a very important and successful part of the more targeted approaches, which make sure that people such as your constituents, who need the assistance, get the targeted assistance. It is a matter of saying, "We need to provide them with the training and skill-building opportunities, because things that they have been doing in the past do not come back in the new world for whatever reason." If Covid leaves this effect on the economy—if certain activities do not come back, or they do not come back to anything like their full extent—then we need to target the policies in the broadest sense to help them get the training, skills and opportunities.

What we know from the past is that one of the things that is most destructive for people and the economy is longer-term structural unemployment. That is what we had coming out of the 1980s to a much greater extent. We must avoid that. I am more optimistic for one reason. In terms of the parallel with the 1980s, yes, you are right that there are specifically badly affected groups. The added thing in the 1980s was that there was a very concentrated redundancy of skills, and it was much more geographically concentrated. I do not think the economy is the same today. It has changed in that respect. Please do not assume anything I just said takes away from what I share with you, which is the importance of making sure that those groups that are much more badly affected get the support going forward, where it is right to target.

Q26 **Rushanara Ali:** I hope the Chancellor is listening to what you are saying here. Jonathan Haskel, you put your hand up. While you are answering, could you also reflect on the 1.3 million EU migrants who have left the UK, a significant number, including hundreds of thousands from London? If they lost jobs and left, those numbers will not be reflected in unemployment data. What are the implications and the costs of that if they were to return? How do you compare the impact of Brexit on unemployment with coronavirus and its impact on unemployment?

Jonathan Haskel: Before I answer that good set of questions, I want to echo what the Governor and Ben were just saying. Obviously, nobody on this committee wants to ignore or in any way minimise the hardship that people face. You mentioned your constituency; in Bethnal Green and Bow there are massive amounts of hardship being faced, but I think the analogy with the 1980s is misplaced. I will try a fact: when we went into the 1980s recession, roughly speaking, 25% of value added was in manufacturing. In about 10 years that had fallen to around 10%. If you look at that span of 10 years and ask about hotels and restaurants, which are perhaps the most affected by the Covid situation, it has gone from around 4% of the economy to around 6% of the economy.

Q27 **Rushanara Ali:** With respect, I was reflecting on Ben Broadbent's point that certain groups fare worse than others in recessions; that is well documented and well established. In that sense, there will be common traits between different recessions.

Jonathan Haskel: I completely agree. I just wanted to get some numbers on the table about manufacturing since we were talking about manufacturing.

Going on to Brexit, this is a difficult issue. You will have read the report by Jonathan Portes and Michael O'Connor, where they try to record this number. We are still trying to get our arms around this number. As you know, the source of the difficulty is that the response rates to the Labour Force Survey have fallen very sharply. They have fallen by 15% overall; they have fallen by about 30% for foreign-born people and 12% for UK-born, and because the ONS does not quite know how to react to all of that, it has had to make various adjustments.

Here I should declare an interest: I sit on the UK Statistics Authority, which looks after the ONS. It could just be that this is genuinely a sampling problem: that the underlying population has not changed but the sampling difficulties have brought this about. You will know that the sampling difficulties are incredibly difficult; phoning people up and going round and asking people in the current conditions is very hard. The situation there is very much, "Watch this space," because those numbers are consistent with nothing happening in the underlying data at all, it just being a sampling problem, although consistent, as you suggested in your question, with a large number of foreign-born people going home. We do not yet know the extent to which they would have been unemployed and therefore whether that is incidental unemployment. As far as the Bank is concerned—this goes back to what you were asking Ben earlier—in terms of our projections for unemployment and all of that, we would be working very closely with the ONS to try to figure out what all those various numbers were.

Lastly, you asked about the implications for Brexit. Again, without a solid handle on the various movements in and out, it is a little early to say what those Brexit movements are. Generally the evidence seems to suggest that the movement of migrants has a rather small effect on labour markets, but we are somewhat in the dark here. I hope, with a bit of co-operative work with other agencies, we can get a much clearer picture soon.

Q28 **Dame Angela Eagle:** I just want to come back to equivalence very quickly and then go on to talk about international issues. Governor, could you let us know what the implications would be of losing the other 75% of the clearing business that you referred to in your statement, both in jobs and earnings for this country?

Andrew Bailey: It is hard to be precise about that, but let me try to sketch out an answer that puts it into context. Let me start with something else that has been in the news, which is the movement of EU equity trading from London to Amsterdam. It is worth saying on that, as a number of commentators have said, that what that does not tell you is where the trades are actually being originated. It tells you what exchange they are passed over, what system they are passed over, but it does not tell you where the activity that originates them happens. It is quite likely that more of that is still happening in London than the headline numbers would suggest.

You could say that almost any piece of infrastructure, whether it be a bit of clearing infrastructure or a bit of trading infrastructure, could have the same effect, but the issue I would pose in opposition to that is there comes a point where the critical mass of activity and infrastructure that is the UK financial services sector erodes. It goes away, and the underlying origination eventually goes with it, because people start to say, "There may be reasons for being in the UK but they are diminishing." I cannot tell you an exact answer to that question.

Q29 **Dame Angela Eagle:** But it is more of a process. You are saying there is a critical mass, and then you can lose a lot more very quickly.

Andrew Bailey: Yes, it is a process. That is a very good way of putting it. You cannot say, "The marginal contribution of this particular piece of activity or this particular piece of infrastructure is the following," but it is a process, exactly. As I say, the particular thing that I was highlighting is that if location policy seeks to drive euro business as a whole into the euro area, that starts taking people from the rest of the world who are used to doing business in the UK to doing business outside the UK, and we are a global centre.

Q30 **Dame Angela Eagle:** Do you think that, in retrospect, there was a mistake made in not having enough of a financial services deal in the Brexit deal? What we seem to have now is the EU trying to nick as much business as possible while holding out on equivalence, and in some ways treating this as a competitive way of onshoring as many financial services as they can within the EU.

Andrew Bailey: The challenge with that is that it implies or suggests there was a moment in time, in the past four and a half years or whatever it is now, when that sort of deal was on the table and that it was not taken, and that is not the case.

One of the other reasons I drew in this point about location policy is precisely because in my experience—it goes back before 1999, but 1999 is a relevant date because that is when the euro was created—this issue of location policy is not new. We are not talking about something that has been created afresh by Brexit. Brexit has given a renewed opportunity to something that had gone into the background, although it has not always been in the background since 1999. You cannot say there was ever a moment when there was another deal on the table and it was not taken.

Q31 **Dame Angela Eagle:** The *Monetary Policy Report* deals with the main lever that you as a committee have to wield in helping to steer the UK economy, and that is interest rates. Interest rates are at historically very, very, very low levels at the moment. Some economists might even say that your instrument is like pushing on a string, because monetary policy ceases to be quite as influential the lower interest rates get. Do you think this means that you are less influential, simply because monetary policy is less influential, or do you think that QE gives you all the firepower you need?

Andrew Bailey: I will start off, and I am sure my colleagues will want to come in on this because it is a very important question. It has changed things in the way that I tried to set out in my speech at the LSE the other day. We now have to do two things. I do not want to suggest the early MPC had it easy; it has always been an analytical and exacting decision-making process, but they were essentially deciding the level and setting of a single policy tool, which was, as you said, the interest rate.

Once you get near what is often called the effective lower bound, and there is no question that, wherever it is, we are near to it—much nearer to it, certainly—we have had to evolve to a second set of decisions, which are about the toolbox decisions. What tools can we have in the box and how do we use them? Interest rates are obviously still there, but you are right that there is a debate; there is a debate about the force of the transmission of rates into the economy when you get down to these levels. Over the last decade or more, quantitative easing has been the tool that has come on to the scene.

The third tool we talk about a lot and that we are using at the moment is forward guidance, and how much we can influence expectations by forward guidance and how we use that. That is another bit of the toolkit.

Q32 **Dame Angela Eagle:** Forward guidance sounds a bit more string-like than even a piece of string.

Andrew Bailey: It is shaping expectations. Monetary policy is forward-looking. The committee has been debating and using this tool for eight years, nearly. Other central banks are as well; we are not alone in this, by any means. We have had to, first, innovate to get more tools into the box, and, secondly, give a lot more attention to those tools.

My final point is crucially important, and one we emphasised in the *Monetary Policy Report*: we have to keep the decisions on the current setting of policy properly separated from the work we are doing on the toolbox, because there is a great temptation for outside observers and so on to try to infer from what we are doing on the toolbox what we are going to do next month in the policy decision. That is not the case, because we have to be much more forward-looking in toolbox decisions as to what sort of tools we want going forward. In that sense, the point you are rightly making underlying this has become a much more complicated and multidimensional landscape than it used to be.

Q33 **Dame Angela Eagle:** That is very interesting. I know that subsequent questioners are going to probe on some of that. Richer nations are progressing their vaccinations far faster than poorer nations. To what extent does your committee think this will disrupt the international community and the international economy over the year, and what effect might that have on our recovery?

Andrew Bailey: There is a world forecast that underlies and is part of our UK forecast and feeds into it. The whole question about the impact of the pandemic on other countries and the vaccination rates is an input to that. It is relevant there.

More broadly, the UK is chairing the G7 this year, so the Chancellor and I have spent quite a bit of time on this. Ben is also our G7 deputy. There is an externality here. Global vaccination is important. It is important for all sorts of reasons. It is important in economics because otherwise we do not solve the externality that is a pandemic, because a pandemic is a huge externality in that sense.

Q34 **Dame Angela Eagle:** Can I ask finally about the US economy, because it has such an impact on the global economy? It grew much faster than the EU economy in the last quarter of last year, and it seems to have been less affected in terms of its own performance by the effects of the pandemic. How would you expect inflation to go in the US, and are you worried about what effect that might have, were it to manifest itself on global economic prospects?

Andrew Bailey: I am not worried about inflation in the US. I am confident that the Federal Reserve is a very capable central bank. You are right that there is a different pattern of growth in the US. There is a different pattern of incidence of Covid, and there is a very different pattern of lockdown and other measures, not just between the US and other economies, but within the US as well. The US has quite a rich tapestry of measures in that sense.

Dame Angela Eagle: It is called being a federal state, having such strong—

Andrew Bailey: I will stop where I have got to on that point. We have quite a strong growth forecast for the US for this year. At least when we did our forecast back in January it was strong by comparison with others. The big question with the US economy is what the fiscal package ends up being. It is not agreed yet. We had some allowance in there for the fiscal package, which is probably the main reason we have a somewhat stronger growth forecast that others did. Our forecast at that time was probably a more contemporary one, so we were able to build in some of what we could see the new Administration was indicating it wanted to go towards. That is what explains that. I am not worried about inflation in the US. The Federal Reserve has been very effective.

Q35 **Dame Angela Eagle:** Are you saying that, in some ways, the fiscal package, which is large in the US, may help power the global economy out of its current doldrums?

Andrew Bailey: Yes. It will certainly contribute to global growth, because the US is obviously such a sizeable part of the global story. There will be a positive spill-over from that. There is quite a debate going on in the US about what the package will be and also what the impact of the package will be. We have some of the world's most household name economists debating it earnestly. It is not agreed yet, so we will see what it is. Yes, there will be some positive spill-over, because the US is that significant.

Q36 **Mr Baker:** I refer to my registered shareholding in Glint Pay. Governor, I really enjoyed your recent speech on the banking system and the challenges for a modern central bank in which you said something really interesting, pointing out that 25 years of the same regime is quite a long time in the historical sweep of monetary policy. You prompted me to think that, between 1997 and 2010, as it happened, M4, broadly speaking, tripled, with big credit expansion. I hope you will not mind my referring to your excellent predecessor, but I asked Dr Carney, before this Committee, "Is this enormous expansion of debt not a mechanical consequence of the policy choices that have been made to try to deal with the global financial crisis?" He replied, "Big picture, yes, I would agree with your characterisation."

Just reflecting on the monetary regime that we have and what has happened since we had that exchange, where does this enormous expansion of debt go? What does it mean for the monetary system?

Andrew Bailey: As you say, in a sense, the effect of using asset purchases has been to increase the stock of liquid assets and, therefore, to have that effect on the monetary system. I would agree with Mark Carney in that sense. If you think about it through a traditional quantity theory of money framework, where MV equals PT, you have had an increase in M but not in V, so the velocity of money has not risen. I cannot say it is something I look at every day, although I probably should. In effect, there were many people in the early days of QE who were saying it would lead to hyperinflation, and it has not.

Let us face it: as we said before and as I said in the speech, the challenge is to get inflation up to target at the moment. If you look at it through that quantity theory of money framework, it is low velocity that has gone with it and that has, in a sense, in that framework, held inflation back on that side of the equation, and that is still the case. In that sense, those predictions of high inflation have not come to pass, I would say. My colleagues may want to come in on this.

Mr Baker: Yes. Ben, I can see, is itching to make a contribution, and I am itching to hear it.

Ben Broadbent: I do not know about itching but I just wanted to point out one thing. You talked about the expansion of debt since 1997 and then you spoke about the result of measures since the crisis.

Mr Baker: Yes. Sorry, I was trying to look at the broad sweep.

Ben Broadbent: Indeed, but those are two very different periods of time, and debt has not increased since the crisis. Household debt is lower. Mortgage debt and consumer credit are lower. Corporate debt is lower. It is not the case that we have become more indebted since the crisis. The Government have become more indebted.

Mr Baker: I had in mind debt overall.

Ben Broadbent: Indeed, but it is not the case that the private sector has become more indebted; it is significantly less so since the crisis. In terms of the evidence that somehow QE has, therefore, caused an increase in debt, I really do not see that that is the case.

Q37 **Mr Baker:** That is not quite what I was getting at. The point I was getting at is the overall level of indebtedness, particularly taking into account Government indebtedness. It is very high.

If I move on to something else that Mark Carney said—you might have been there at the time, Ben, in 2014. He told the Committee, in response to me, that monetary policy was at "extraordinary, if not emergency" settings. Since then, we have had seven more years of near-zero interest rates and more QE, so my question to all of you is whether we have become accustomed to extraordinary, if not emergency, monetary policy settings. Again, I am trying to flesh out what that means for our monetary regime.

Ben Broadbent: We target inflation. One of the things that has happened globally, not just over the last 10 years but arguably over a much longer period of time—and indeed, I read something saying centuries—is that the interest rate required to keep inflation stable has come down. In that broader sense, we do not cause low interest rates. What drives that neutral rate causes us, fundamentally, to have to set low interest rates.

To put it another way, if we had made an attempt to keep interest rates even at 2%—certainly at 3%, 4% or 5%, the sort of levels that prevailed in the 2000s, and goodness alone knows the levels that prevailed in the 1980s—we would have deflation. That is the implication and, therefore, in some sense, you should judge monetary policy not relative to those rates in the past—in the 1980s, by the way, they were extraordinarily high relative to history—but by what is necessary to stabilise inflation.

In that sense, I do not know that one can call this an emergency. It is what is necessary to stabilise inflation. That necessary rate has come down and there are lots of deep factors that might have caused it, none of which has to do with monetary policy.

Q38 **Mr Baker:** I know enormous amounts of thought go into these answers and a great deal of study behind the scenes, but it is difficult to get across the detail of it in such short sessions. I would just observe that, if we look at the evolution of Bank rate, it was slammed on the floor after the financial crisis. I hope you will forgive me for saying that I struggle to reconcile what you have just said, which is a well-argued point, no doubt backed by enormous amounts of intellectual effort. I just struggle to reconcile that argument with the actual evolution of Bank rate over the course of the crisis, because it looks like it reflects what Mark Carney said to me—that it was a policy choice: we have had a terrible crisis. We must slam the foot on the pedal with monetary policy by driving down Bank rate. It is there to be seen in the evolution of Bank rate. How do you reconcile the answer you have just given with the evolution of Bank rate?

Ben Broadbent: The evolution of Bank rate was necessary to keep inflation from falling below target. That is the answer I gave. The evidence is equally clear that that is what has happened. We have not seen a huge acceleration in inflation. We needed the lower rate in order to prevent a fall in inflation. In that sense, it is not helpful to look at Bank rate in isolation. You can go back to the 1980s, when you needed far higher interest rates to prevent inflation from rising. We are in a very different situation from then.

Comparing simply the level of Bank rate now with particular points in the past does not tell you about the stance of monetary policy. The stance of monetary policy is better judged after the event by what happens to inflation and currently, maybe, by inflation expectations, but more fundamentally, where is Bank rate relative to that neutral rate? Unfortunately, we do not observe that neutral rate directly. As I say, we can kind of see it after the event, given what happens to inflation. That is a better guide.

Mr Baker: We will come back to the neutral rate in a bit, because I want to ask you about negative rates.

Dr Vlieghe: It is not useful to characterise these very low interest rates as emergency monetary policy settings. It is just not right, for the reason that Ben said, which is that there is a real interest rate in the global economy that has been driven much lower by an increasing desire to save and a reduced demand for investment. All we are doing is matching that rate.

As to the lower level of interest rates since the crisis, we have evidence of what Ben said: that if we had tried to raise interest rates, the outcome would have been worse. Some countries tried, within a few years after the crisis, to raise rates, and what happened is that, after a few years, they had to cut them again, because they faced more disinflation and ended up with rates even lower than where they were before, showing very clearly that things would have turned out worse if we had tried to raise interest rates. We are just matching the very low neutral interest rate, for entirely structural factors that are not a policy choice. I disagree with the statement that it was our choice and with the statement that it is at an emergency level. Neither of those things is true.

Q39 **Mr Baker:** That is a very interesting evolution of the Bank's understanding of monetary policy compared with where Mark Carney was at the time he gave those answers.

Dr Vlieghe: I made this point already. As soon as I joined the committee, I made exactly those same points six years ago, so it is not an evolution in that sense.

Mr Baker: I am confident that scholars will pore over these things in due course.

Chair: Sorry to interrupt, but Jonathan might want to come in.

Jonathan Haskel: It was exactly the same point as Jan and Ben have made, so I will not repeat it. It is all relative to the neutral rate, which is how one should judge these things.

Q40 **Mr Baker:** I made the point about the step change around the crisis. Let us talk for a moment about distortionary side effects. Again, forgive me, but Mark Carney gave us so much wonderful evidence. I am sure that, in 10 years' time, if I am still here, I will be referring to what Andrew Bailey told us.

Andrew Bailey: You do not have to.

Mr Baker: Mark said to the Committee, "It would be absolutely welcome to raise interest rates since it would take some pressure off macroprudential policy." Again, that is very interesting, because implicit in that is that low rates create demands on macroprudential policy. Could you tell us a little about those demands on macroprudential policy that are created by low rates?

Andrew Bailey: I would strongly agree with Mark on that. Macroprudential policy is, in a way, the instrument that we have had to bring to the fore since the crisis, and there are broadly two reasons for that. One was the fault lines that we saw during the crisis and the absence of it in the pre-crisis regime.

Secondly, I would go beyond that and say we have seen fault lines emerge in the post-crisis world. A very good example of this is things we saw almost a year ago, in the third week of March last year, when we saw very big tensions in non-bank markets and had to step in and deal with them. Mark is right. One of the consequences of the growth of asset markets, for instance, has been that macroprudential policy has to step forward.

I do not think that Mark and I would disagree on this, but I would put it slightly differently, in that having monetary policy without macroprudential policy was an unbalanced regime. We were asking too much of monetary policy. You may remember that, in the pre-financial-crisis era, there was a great debate about so-called pricking bubbles and whether monetary policy was there to prick bubbles. The general consensus among monetary policymakers was that that was not what they envisaged monetary policy to be doing, but the logical consequence of that line of argument is that you need another tool, and macroprudential is that tool.

The point I would emphasise is that I would not say that it puts strain on macroprudential policy. It has made it even more important and vital than it was before.

Ben Broadbent: It is hard to say what caused what, given that we have both policies in place, but it is worth looking at the evolution, just as it is with debt, of asset prices since the crisis. I was just looking now, funnily enough, at the FTSE to see where it was. It is at a level that we first reached, even in nominal terms, in 1999. If I compare equity prices in real terms, which is a better comparison, with where they were at the time of the crisis, UK equities are still about 18% lower. If you look at the price of UK-focused equities, because our indices are quite global, it is somewhere between 35% and 40% down. This has not been a strong period for equity prices; it has been a very weak one.

House prices have been pretty flat. They have risen in line with wages—down a bit in the crisis and up a bit since, but they are no higher relative to wages than they were in 2003. It is not the case that we have seen very strong growth of risky asset prices, at least since the crisis. In that sense, there may have been other things for macroprudential policy to do, but I do not see evidence that macroprudential policy is having to lean against risky asset prices because of some over-inflationary effect from low interest rates. I do not think that is there. The FPC has in place cautious restrictions on the extent of high LTV and high LTI mortgage borrowing, so that may have had an effect on the housing market. By and large, it is not the case, just as it is with debt, that we have seen very strong growth since the crisis; if anything, the opposite has been true.

Q41 **Mr Baker:** I need to press on. This is an extraordinary time in the development of our economy, and a time of extraordinary challenge for central bankers. I happened to pick up earlier a paper that the Bank produced, *Money creation in the modern economy*. It really sets out for the public how the system works, in a way that is not well appreciated. For example, it explains how the majority of money in the modern economy is created by commercial banks making loans. Do you agree with me that the public do not generally understand that that is how the system works? They perhaps think that deposits are being taken in and loaned out. Dr Vlieghe, do you think the public understand how the modern monetary system works?

Dr Vlieghe: I do not know how well they understand it. I teach this stuff and I know that my students do not know it when they come in, but they certainly know it when they leave my course.

Mr Baker: I bet they do.

Dr Vlieghe: I spend a lot of effort explaining exactly this process. People generally raise their eyebrows when you say something like a bank can simultaneously create deposits and a loan, but a mistake that people often make is to go from there to thinking that banks can create unlimited deposits and loans, which is, of course, not at all the case. That is exactly what the central bank puts the brake on, when it becomes inflationary, by rising interest rates. It is exactly how it works, and whether you find that surprising or not, that is the monetary transmission mechanism and that is how the modern banking system works.

Q42 **Mr Baker:** I am reassured that your students learn that, but just thinking about the public, there will be people, perhaps even watching this, who might have lost everything, because they were unable to repay a loan? There is the banking system, creating money at interest when it loans, and yet, if somebody is unable to pay, they might well lose their home. Does anybody think through whether that is ethical? Is it a fair and ethical way of operating a monetary system?

Andrew Bailey: I am now almost trying to put my old hat back on. We have done a lot of work over the years to try to limit the impact of mortgage lending going bad. If you look at the mortgage default rates over time, they are a lot lower than they were 30 years ago, for instance. We have had to do a lot on the consumer credit side, with bad and, frankly, dangerous lending practices. That has been done but it is a big step to say that that is a product of the monetary system as such. It is quite a leap to make that statement.

Q43 **Mr Baker:** It is a matter of fact, though, as we have just discussed, that banks create money when they lend. They do it at interest. If you fail to repay that loan, you can lose your assets and be put out of your home for it. That is a matter of fact, is it not?

Andrew Bailey: The counter to that would be that, of course, over the last century, we have moved from being a country that was not a home-owning society to one that is. Many people would say that that has been an advance in society. You may want to debate that point.

Q44 **Mr Baker:** I want to bring Ben in, and then I have to get on to negative rates. We do not have time to discuss this, but I will just say that, when I look at median pay versus median house prices in my constituency, I think there is something terribly wrong.

Ben Broadbent: Very quickly on that point, it is true nationally that house prices, relative to average household income or to average wages, are at the same level they were before the financial crisis; they are actually marginally lower relative to wages.

On the point that Andrew was making about the link between the monetary system and mortgage defaults, I agree with him and do not really see that link. Imagine a system where the people making mortgage loans were funded in an entirely different way—not by deposits but by equity or something else. That would not eliminate mortgage defaults. Mortgage defaults unfortunately happen because, as you say, while it is a reassuringly small fraction, there are some people who are overextended and their income falls away.

Mr Baker: I was really referring to the asymmetry.

Ben Broadbent: That would be true no matter how the banks were funded.

Q45 **Mr Baker:** I would so like to spend much more time on this, but just to turn to negative rates, we have said that it could be in the box of tools but people should not expect to do it. Firms have been told to prepare for negative rates. Can we try to explain to the public what this means? I am trying to imagine that you are in the business of lending your own money. I come to you and say, "I would like to borrow £100, please," and Ben Broadbent says to me, "Certainly, Mr Baker. You can borrow £100 and, what is more, I will pay you £5, too." Is that not what negative interest rates mean in retail language?

Ben Broadbent: It would. One of the things I would point out straightaway is that, when you look at the experience of other countries, retail rates, whether on deposits and certainly on loans, have not gone negative. Even in the euro area, where you have had negative official interest rates for over six years now, it has not been the case that retail interest rates have gone negative.

What does go negative, of course, is the official interest rate, which is formally the interest that the central bank pays commercial banks on their reserves—their deposits—with the central bank, but that does not mean and has not meant in other jurisdictions that retail interest rates, whether on deposits or loans, have gone negative.

Q46 **Mr Baker:** I appreciate it is a very complex subject and difficult to make easy to access, but the point I am trying to illustrate is that there is a certain absurdity, surely, to negative interest rates compared with that great subject you touched upon earlier—the natural rate of interest—which is related to people's time preferences for consumption.

Ben Broadbent: It is. Time preferences go on about which interest rates you should use for that: whether you should use the risk-free rate or some other discount rate that is probably higher than the risk-free rate. You should use the latter; otherwise, you would see enormous dis-saving around the world, and we have not seen that.

I understand it is a highly unusual situation, but in terms of that neutral interest rate, there is no particular reason why, given that it has been falling for a long time—not just since the crisis, but, I would argue, for a long period before that—the appropriate level of real risk-free interest rates, which is already negative, in principle could fall below 2%. If it falls below -2%, the appropriate nominal rate, consistent with an inflation target and inflation expectations of 2%, might have to fall below zero. That is the issue we are talking about. The issue that we are discussing at length is how effective rate cuts would be below zero, not that they are somehow intrinsically impossible.

I can understand that the public finds them extraordinary in some ways, but our debate is not so much about that; it is about whether they would be effective. On the idea that somehow the neutral rate or the appropriate real interest rate cannot fall further, I do not see why that would be the objection.

Dr Vlieghe: When Mr Baker talked about the absurdity of borrowing at negative rates, I am afraid he is suffering from something called nominal illusion. In real terms, this has happened many times over the past century. Real rates have been deeply negative, which means that, if you borrow, you get more back and, if you invest in safe assets, you end up with less than you started with. That is not unusual. That frequently happened in the 1930s and the 1970s, and it has been happening since the crisis. Real interest rates have been negative since the financial crisis, so there is nothing absurd and not even anything new about it. It is just a failure to make the distinction between nominal and real things.

Mr Baker: I am very happy to have received that lesson. Thank you very much.

Jonathan Haskel: Steve, you asked whether people understand this, and Jan's students obviously do. A couple of months ago, there was a very interesting report from the Economics Statistics Centre of Excellence on the public understanding of economics. One of the things that the public understand very well is interest rates. They are well-versed in this. They look at mortgages and their bank accounts and all that kind of thing. There is lots of useful information there for this issue about public understanding, which is very important.

Q47 **Mike Hill:** I am just going to touch on quantitative easing, particularly the state of the ongoing £150 billion that was authorised by the committee last time out. Governor, on the latest round of QE, the MPC minutes say that the pace of purchases could be slowed down. Under what circumstances would you want to slow down the pace of purchases?

Andrew Bailey: Just to put some context on that, we said that we would conduct this round of QE broadly over the course of this calendar year. We are currently conducting £4.4 billion of purchases a week and, on the current schedule, that would not run throughout the whole of the year. That is okay. The choice is ours, as it were. We thought that was an appropriate place to start, given, particularly going back to the discussion we had earlier, the impact of Covid as we saw it when we took the decision. We retook that decision at the most recent meeting, in the context of the fact that we issued the February *Monetary Policy Report*, because, in the context of the lockdown we are in and the impact of that on activity, we thought it was appropriate to continue. By the way, that number is a lot less than we were doing in the spring of last year, when we were conducting about £13.5 billion a week of purchases on average, so that is £13.5 billion down to £4.4 billion.

We could decide to reduce the pace. We could decide to stretch it out over the whole calendar year. That is something we could do. In my view, the decision would hang on several things. It would hang on the outlook for the economy but it would also particularly hang on market functioning, because there is an element to QE in terms of what I call financial conditions. It is not just rates, by the way, but also the functioning and efficiency of markets, and how they are supporting intermediation throughout the economy. If we decide to take that decision as a committee, we will look at a whole range of indicators that we look at on market functioning as well as our outlook for the economy in terms of the prospects for the economy. That is how we would do it.

I should say that it is our normal practice to review that pace of activity at every meeting we hold of the MPC, so we will do it again in March, and either confirm it or change it. That is how we do it.

Q48 **Mike Hill:** The minutes also say there is scope to look at "the technical parameters of the gilt purchase programme." In layman's terms, what does that mean?

Andrew Bailey: That is really more to do with headroom, particularly for QE. I will come on to a little bit about the weekly operations in a moment, but I remember about a year, when I had my hearing before taking up the role, and Mark Carney had done his last appearance only a day or two before me. We had both been asked the question, in what seems like a completely different era, as to what we thought the headroom was for monetary policy, and we both gave a number that is now wildly out of date in terms of what has happened since. Part of that, of course, is that we have been able to undertake more asset purchases, because the stock of gilts has increased.

By the way, let me just immediately, before we go on, knock on the head any suggestion that we are conducting so-called monetary finance—we are not—but there is a relationship between the stock of gilts that we can purchase and what we can do. As you rightly say, the policies that we have within that are, in good part, designed to ensure that our operations, in and of themselves, do not influence the operation of the market more than we want to, including prices.

We buy in three buckets of maturities: short, medium and long. We have pre-set relationships for doing that and an order in which we do it. We also have caps on how much of each bucket relative to the outstanding we want to own, because that all has to do with basic market liquidity. Our aim is that we do not want to start paying up in auctions because there is a shortage of stock out there to buy.

I should say, of course, that none of those things are cast-iron rules that one can just pick off a shelf, as it were. They are all a matter of judgment and we look at them quite often. We could adjust them, if we felt we needed to and there was a good case for doing it, so we can keep those under review. Every day there is an auction, I look at what cover we are getting in the auctions and, therefore, what price we are paying. We keep that under review and I talk to the team regularly, because that is an indicator also as to the functioning of the gilt market within those particular buckets—the short, medium and long.

We and our markets staff look at all of those things constantly to make sure that we are getting value for money from the programme, frankly, because, if we were paying up, that would defeat the objective. They are good and sensible policies to structure in our purchases. It also means the market has clarity on what we are doing. We have preannounced all these things, because we want transparency. We do not surprise the market in that respect. We could review them, but there is no need to review them at the moment. They are functioning very effectively.

Q49 **Mike Hill:** I want to engage the opinion of your colleagues on the panel, because there is clearly potential there to slow down the pace of purchasing and look at a re-evaluation of the parameters, but there appears to be some nervousness about the latest round of QE in particular. Are there any circumstances in which you would vote to cancel it before it was completed?

Ben Broadbent: Can I just make a distinction between the pace and the idea of "cancelling"? It is not the same thing. We have set an objective. We have made a decision on the target stock of gilt purchases. That is the most important thing; the pace is secondary. Indeed, before the spring of last year, when we had what we called this huge dash for cash—a sudden increase in the demand for reserves and big strains in financial markets—the committee had never expressed an opinion about the pace of purchases. It was simply left to the engine room, if you like, of the Bank that conducts the auctions to decide what pace was appropriate.

Now that we are out of the immediate crisis conditions that led us to accelerate the pace last spring, the pace is not so important. Having said already not just the aggregate number, which is the more important thing, but that also we expect to complete it around the turn of this year, it would take significant news for us to change that pace. My expectation—this is not a promise—is that we would maintain it roughly as it is.

As for the target stock, that, of course, can be changed in the interim, in principle. It is a matter for the committee. It is a monetary policy decision but that could, in principle, be changed, even if we are in the process of completing the previous decision or changing the stock, if you like. I would distinguish between the more important thing, which is the target stock of asset purchases, and the pace at which any particular decision is then implemented.

Q50 **Mike Hill:** Thanks for explaining that. I get the impression that any nervousness around that has dissipated. Mr Broadbent, up until now the MPC has said that it would raise Bank rate back to 1.5% before trying to withdraw QE, but you have now commissioned a review of that approach. We heard the Governor's support for this in the summer. What is the range of views on the rest of the committee on that approach?

Ben Broadbent: We do not have, even individually, the views, because they have yet to do the review. That is the reason we are doing it. To put it into context, at the time the view was that we feel more certain about the effects of standard changes in interest rates; we have more evidence of that. Therefore, all else equal, were we to embark on a tightening path, or at least a path where either decision was in scope—either raising interest rates or shrinking the balance sheet—we would prefer to use the first and to get to a position where we could make reasonable cuts before we wanted to embark on any quantitative tightening, if I can call it that.

What has changed since is the huge amounts of QE we had to conduct last year. The balance sheet is now that much bigger. Andrew is in a much better position, I am sure, to make the points he made last summer, but the key takeaway from that and from Andrew's speech to Jackson Hole is the potential that, if you face another sudden surge in demand for reserves—the sorts of strains we witnessed last spring—and you use up some of the potential space that you have, there might be an argument for trying to restore that space even before Bank rate has got to 1.5%. I am entirely open-minded on this. We have yet to do the review, and I will be interested to see where it comes out.

Let me end with one final point. Whatever decisions are taken on the ordering, the most important thing, on which I can tell you every MPC member will give you the same opinion, is that, overall, the stance of policy will continue to be set with the inflation target in mind. These are hypothetical points. They are points that assume that, at some point, there might be a need to tighten policy. It is not where we are now and they are only conditional in that sense, if we were in a position to want to do this, and we would only want to do it if we thought inflationary pressures were increasing. That may be some time off, but, as I say, I am open-minded on the sequencing and we will look forward to the review and discussing it with fellow MPC members.

Andrew Bailey: I just want to reinforce what Ben said. I am completely open-minded about where we are going to take this to. The committee last reviewed this in 2018, and two things have changed since: first, currently, on the yield curve, it does not get above 150 basis points.

Obviously that can change in the future—do not get me wrong—but, as of today, it does not get to that point.

Secondly, during the course of this year, the Bank of England's balance sheet will go through to £1 trillion, which is over 40% of UK GDP. In terms of our ability to deal with future shocks, bearing in mind we have had two major shocks—we have had a global financial crisis and a pandemic—these are very big questions, and it seems to me imperative that we review them from time to time, because we have to be forward-looking in terms of how we operate our policy and what capacity we have to do things going forward.

Q51 **Alison Thewliss:** I have some questions on the impact of QE on the exposure of public finances to rises in interest rates. Witnesses from the OBR, including your former colleague, Charlie Bean, have raised with the Committee the fact that QE effectively swaps long-term Government gilts for overnight debt, potentially exposing the public finances to a greater impact from any rises in short-term interest rates. Governor, first of all, does that give you any particular concerns?

Andrew Bailey: It is an interesting observation from the OBR. We have not really talked to the OBR about this, but I have certainly heard the evidence that Charlie and others have given. The point I would make on this—I know this is some work that Jan did, so he may want to comment on this—is that, when you look at the average maturity of UK Government debt and take into account the effect of QE, it has not really changed. Jan will correct me but I think it is about 11 years or something like that, and it is longer by at least two years than the next longest among the advanced economies. If we stop there, it suggests that, while there is an accounting point, the average maturity has not changed.

It causes an interesting secondary question, which is what the average maturity would have been absent QE, but I would instinctively argue that it is not right to think that it would have been longer absent QE. Jan, you have spent quite a long time thinking about this. I do not know whether you want to come in.

Dr Vlieghe: The way I would phrase it is that, directionally, it is correct that, if you do QE, you swap a bit of long-term debt, effectively, once you consolidate the Government and the Bank of England's balance sheet, for some very short-term debt. In part, that is how QE works. One of the channels is that we take some interest-rate risk out of the market and put it on the Government's balance sheet.

The more important point is that what we end up doing, looking at it quantitatively, is we broadly offset the lengthening in maturity that the DMO did over the last decade. We broadly offset it, so that the maturity is about the same as a decade ago, once you make that QE adjustment.

Quantitatively, even though it is correct, I do not want people to have the impression that now, all of a sudden, the UK is uniquely vulnerable to its

Government finances or to short-term interest rate changes, because we started with a position where the UK's debt was much longer maturities than other advanced economies, and it still is, so we had that scope.

Of course, as far as the Bank of England is concerned, this is a side effect. What we are trying to do is meet the inflation target. This is something mechanical that happens in the process, and so we do not think this is either good or bad; this is just a product of the tool that we have.

Q52 **Alison Thewliss:** I am not sure whether it is reassuring that we are not in a unique position in what we are doing here, if it is more commonplace. I was wondering whether you felt the latest round of QE was having enough of an impact on the economy to justify the risk of making the public debt more expensive further down the line.

Andrew Bailey: As Ben was saying, you have to go back to the point at which we announced it, because the stock of QE is the relevant thing. When we announced the £100 billion further stock of QE, you have to look at the situation the economy was in, and the inflation forecast. We certainly took the view that it was necessary to give us greater confidence that inflation would move back towards target. There is nothing in the February *Monetary Policy Report* and the forecasts we produced that really changes that view. It certainly did not change that view when we deliberated it in the February Monetary Policy Committee meeting. In that sense, my answer would very much be yes. It is doing what we hoped it would do.

Q53 **Alison Thewliss:** The Government indemnify the QE programme against any losses, and it may well make losses if interest rates rise. Does that perhaps give the Government a reason to persuade you not to raise interest rates?

Andrew Bailey: First of all, we are an independent central bank.

Alison Thewliss: I wonder if the line of independence here, when it starts to come to that, becomes a bit of a blur.

Andrew Bailey: Of course, the Treasury Select Committee has an important part to play in that as well. Secondly, it would be a big mistake if the Government did that, and it would not be hidden. If the Government were seen to be doing that, you can be pretty confident that the risk premium that would be embedded in the market and, therefore, the interest rates that would be embedded in the market, and the price they were having to pay on their own debt, would rise. It would be an entirely self-defeating activity, frankly. Anybody who contemplated that would, I am afraid, get a very stern message.

Jonathan Haskel: I do not dispute that one can do these thought experiments about what would happen to the burden of Government debt were interest rates to rise, but of course, if interest rates were going to rise, they would probably rise for a reason; for example, there is lots of growth in the economy and we need to take the steam out of the economy. Of course, if there is lots of growth in the economy, the situation for public debt looks much better. I would just caution slightly. Like I said, there is nothing wrong with doing those isolated experiments, but to then go and say, "Is there not a danger of this or a danger of that?" one might want to take them in a bit of context.

Q54 **Alison Thewliss:** That makes sense. The economist and former MPC member Charles Goodhart put in a letter to the *Financial Times* suggesting that you cease paying interest on reserves and make QE permanent to solve some of these issues. He left it open at the end of his letter as to whether he was "being serious or sardonic," and I just wondered if you had any particular thoughts on this letter.

Andrew Bailey: Charles has a fantastic sense of humour. Having worked with him for a very long time, not only is he a terrific economist but he has a fantastic sense of humour. I read it as well, and I was left completely perplexed at the end as to whether it was a very neat piece of humour. Let me say two things on it. First of all, if we did pay no interest on the reserves or, indeed, on a substantial part of the reserves, we would, effectively, be constraining ourselves in terms of monetary policy, because it would mean that we could not set the official interest rate and it would not have the effect that it is intended to have, so it would be tremendously self-defeating for us to do that.

The second point I would make—and Charles, if I remember the letter/article rightly, does make this point—is that it would, in effect, be a tax. You might say it would be a tax on the banks, but it would not really, because, of course, they would have to pass it on. In that sense, I am afraid it crosses the line into fiscal policy, and that is not the right thing for us to do.

Q55 **Alison Thewliss:** Lastly, I just wanted to ask you about the *FT* survey, which found that investors believe QE is now about financing Government debt cheaply. Do you have any particular thoughts on the findings of that survey?

Andrew Bailey: I am sure we will all come in on this. I made some pretty strong comments on that in the speech I made at the LSE, to which Mr Baker referred. Frankly, it is a very misguided thing to say, in my view. There are a number of things you can say. I might bring Jan in, because I know he has done the numbers to demonstrate that the numbers are different.

Secondly, it unfortunately misses an obvious point. When we announced the QE operations, neither we nor the Government had any idea what the path of Government borrowing was going to be. If you think particularly about last March, I do not think anybody could have known, in real time, what that would be, so I am afraid that is very misguided.

The third thing I will say is just a very fundamental point. Both monetary and fiscal policy will, of course, move in the same direction at a point when we have such a huge downturn—or, in fact, any downturn—in the economy. They are both countercyclical policies. That is the point. We should not be surprised at this. Jan may want to come in, because I know he has done the numbers.

Dr Vlieghe: First, I have a general point: when we do QE, the point of it is to lower long-term interest rates in order to boost demand in the economy, in order to get inflation up. Households and firms will benefit from those low long-term interest rates. Of course, the Government benefits too, but that is not our primary purpose. We are trying to stimulate private-sector demand.

The second point is that people just have their facts wrong. People say, "The Bank of England just buys whatever the Government issues," but that is just factually wrong. You can look it up. We did that briefly during a period of extreme market turbulence. What we bought ended up being approximately what the Government issued, but, at the time we made the decision to buy, we did not know how much they were going to issue, so that was an ex post coincidence.

It was not even a new thing. Several times in 2010 and again in 2012, for brief periods, we ended up buying more than the Government issued. In the second half of last year, we bought just over half of what they issued, so the idea that we are just buying everything is factually not correct.

Ben Broadbent: My colleagues have made most of the points. Looking at the details of that survey, I am not sure why that conclusion was drawn. It was not a direct question; it was simply a few quotes from some of the people who had replied to the survey.

The most important thing for us is to stabilise inflation. The most important measure of confidence in the framework and our conducting the policies for that reason can be found in the surveys of inflation expectations and the prices that tell you what financial markets expect in that respect. Those have not budged. As the Governor and Jan have explained, even at times when it is correct, it is a spurious point, quite honestly; it does not tell you anything about why, fundamentally, we are doing this policy. On the measures that matter in that respect, there is continuing confidence in the framework.

Q56 **Siobhain McDonagh:** I would like to look at Brexit, trade and investment. My questions will seek your views on the impact of Brexit and the prospects for uncertainty, business investment and particularly ballroom dancing costumiers. Governor, I do not know whether you are expert in that field, but we will find out. In January, you told us that the UK-EU trade agreement was a "comprehensive free trade agreement" on the goods side.

Mitcham and Morden is the centre of ballroom dancing costumiers in the world. We have a brilliant local company that has expanded every year since it came into being, but they now find themselves importing goods from the EU and paying no tax on them. When they send them back out to the EU in smaller quantities, their purchasers are paying duty on them, meaning that they, for the first time in their history, even though they export to over 50 companies, are coming up against a real problem in running their business. How many other small businesses are experiencing exactly the same thing?

Andrew Bailey: I have to begin by declaring a great deal of ignorance on the ballroom dancing industry. Please never take me ballroom dancing; I would be an embarrassment to you.

Siobhain McDonagh: If you ever want to go to a costumier, I can take you to one.

Andrew Bailey: I am looking forward to getting back to doing proper regional visits, because, at the moment, I am doing them all by Zoom, so you are on, as they say.

It is a comprehensive agreement in terms of goods, but all such comprehensive agreements, I am afraid—this is where, of course, it is in the detail—do have, in particular, duties attached to them. We all hope, I am sure, that these things are ironed out as much as they possibly can be over time. By the way, as I think we said last time, we put into the forecast that there would be a long-run negative effect of moving from membership of the single market to this trade agreement or any trade agreement of this sort.

Secondly, we also put in that there would be temporary disruption that would last over the first two quarters of this year. When we came to do the February forecast, the evidence that we had—and we do look at a lot of evidence—caused us not to change the assumptions we were making in the forecast on that.

I hope, for your constituents and for every other company in this country—I talk to as many as I can—that, over time, we can find ways to alleviate the impact of all these various issues. I would just emphasise that, when we said it was a comprehensive trade agreement, we also did not say that it would not be without impact. We have always been very clear. Mark Carney was very clear on that and I know he attracted a certain amount of commentary. I have been very clear on that. We had it in our forecast. We have spelled it out in the MPR this time in terms of the assumptions. I hope things can be done to alleviate the position of your constituents.

Q57 **Siobhain McDonagh:** The company is Chrisanne Clover Ltd. How is the picture developing for services?

Andrew Bailey: Services is different in the sense that, of course, far less of it is inside the agreement. Although there is a lot more to services than just financial services, in a way it harks back to what we were saying at the beginning of this session, that there are areas of services that are not covered. Of course, it is welcome news that we appear to be getting towards a more solid agreement on data transfer. That is an important part. There are elements of it that are moving, and I very much hope that all the authorities that now need to approve this stage of the agreement do so, because it is critical, frankly, for both sides. What it does illustrate, of course, is that, while it was important that what was done just before Christmas was done, there is a lot of work still to be done.

Q58 **Siobhain McDonagh:** You told us in November that firms were often saying, "We are as ready as we can be" for Brexit. How ready were they in reality? In what ways could they have been better prepared, if possible?

Andrew Bailey: As I was saying a few minutes ago, we did not change the assumptions in the February *Monetary Policy Report* in terms of both the short-run and longer-run impact of the agreement from the ones we had in November. In that sense, we have not taken a different view on preparedness. It is a very difficult thing. Companies did a lot.

By the way the comment, which really came back from our regional agents, that we are as prepared as we can be, was in the spirit of "and we have tried really hard." Clearly, of course, because the outcome of the trade negotiation was still uncertain—and it was uncertain right up to the wire—when many companies said to us, "We are as prepared as we can be," it was a reflection of the uncertainty they faced. We have to recognise that; it is true. I would not say to companies that they should have tried harder. That would not be a fair comment at all.

Q59 **Siobhain McDonagh:** When you were before the Committee in January, you told us that it was important for the economy to see a reduction in uncertainty and, therefore, stronger conditions for investment, and that the trade deal supported that, though obviously not for Chrisanne Clover Ltd. What is your assessment now of the level of uncertainty?

Andrew Bailey: I would strongly emphasise the comments I made. It is critical, and raising the level of investment in the economy is critical for longer-term growth and productivity growth. I do virtual regional visits at the moment. I have done a number since we had that hearing in January, and the reflection I get back from companies is that they are relieved that there is an agreement and they can see what it is. In that sense, the level of uncertainty has come down, but I would emphasise that it has come down only somewhat. There is still a long way to go to get back to a more normal level.

That is about a number of things. It is partly about seeing how the Brexit trade situation continues to work itself out. Our general assessment is that there was certainly quite a big impact in January on the flow of trade. We have seen evidence of improvement but we have not yet seen any trade data, so we have to be very cautious about what conclusions we draw. Of course, overlaying that has been the effect on uncertainty of Covid, which, again, has its own path. We are hoping that we are beginning to see some reduction now in forward-looking views of uncertainty on Covid, but there is a long way to go.

Jonathan Haskel: Like the Governor, I know nothing about ballroom dancing, but they should maybe speak to Marks & Spencer, which has been having trouble with its Percy Pig sweets and re-exporting, for exactly the same reason. That might be of some help.

On what the Governor was saying just now about uncertainty, similarly to what I was saying earlier about asking individuals what they are going to do with their savings, we ask firms what they are feeling about uncertainty and the amount that they perceive, and Brexit and so forth, in the Decision Maker Panel. The results for February came through earlier this morning. Some 43% of firms said that Brexit is still part of their top three levels of uncertainty, which, remarkably, is the same as it was about a year ago, suggesting that there is some way to go, especially on the service sector side, presumably, to clarify what the implications of Brexit are going to be for those firms, and especially those that are trying to export.

Q60 **Anthony Browne:** I would also like to declare that I have absolutely no ability at ballroom dancing. I tried it once and it did not go well.

I want to ask about your statement at the beginning, Governor, on the location policy of the EU. I found what you said really quite alarming. When I was chief executive of the British Bankers Association, I was quite heavily involved in these negotiations from an industry perspective. You said there are papers circulating about the two potential options of extraterritoriality or cajoling banks to do euro clearing in the EU rather than outside. On that second point, what mechanism could the EU have to do that? How would it enforce it? Do the papers go into that degree of detail?

Andrew Bailey: The ones I have seen are rather speculative on that front. It would be an extraordinary thing if there was a decision to do that, because it would essentially be saying, "We will use some other tool in our locker to get an outcome for which that tool is not designed." Put it that way. That is a pretty extraordinary thing to do. What it is following from is the point I was making earlier, which is clearly a concern that equivalence on its own does not deliver.

Q61 **Anthony Browne:** Do you mean it does not deliver from the EU's perspective?

Andrew Bailey: Yes, exactly.

Q62 **Anthony Browne:** I realise it might be high level and too early to ask, but do you know whether the proposals to cajole banks to do euro clearing in the EU would apply just to EU-headquartered banks, which they presumably could do as the regulator, or whether they will try to impose it on other international banks? I think I am right in saying that most euro clearing in the UK is international wholesale banks, primarily American but other nationalities as well, that are not EU-headquartered.

Andrew Bailey: I should say, by the way, that I have not seen any evidence that these suggestions are coming from EU authorities at the moment. They are coming from market participants, on the whole, who observe this problem. It is a really good question, because the challenge is that you need to make these policies more widespread in terms of their effects to capture the business, and that makes it harder to put the policy into effect, if you have a chain of activity that you are trying to influence.

Q63 **Anthony Browne:** You do not know the status of these proposals. You said they are from market participants.

Andrew Bailey: This is quite serious because the underlying issue is serious: that equivalence on its own does not deliver a stable outcome. It is no surprise to me that we are starting to see speculation there in terms of, "What next?" It is no surprise to me that it is bringing the location policy back on to the table, because, as I say, it is not new.

Q64 **Anthony Browne:** Clearly, this has been going on for many years, and I was involved in some aspects of it. I am interested in the EU's desire for euro clearing to be in the EU, and whether you think there is any need to do that from a financial stability perspective, which is what they normally claim—the Bank of England has its euro line to the ECB—or whether it is just protectionism. Is there a valid financial stability argument?

Andrew Bailey: No, I do not think that there a valid financial stability argument at all, because it clearly works with others, such as the US and the EU. I have talked to many of the people involved in reaching the agreement that they did, and they said it was not easy, but they did reach it and it does work. Essentially, they now have a system in which they sometimes use the word "deferring"; they defer to each other's rules, if you like.

Q65 **Anthony Browne:** That is not for a market that is of such a big scale. You mentioned the €80 trillion.

Andrew Bailey: Yes, but the key thing that we have done since the financial crisis, as I described in a speech that I made virtually at the Mansion House the other day, is that we have put in place, largely under the auspices of the Financial Stability Board, which is a global body that we are all involved in, a set of rules, with the standard-setting bodies that sit under it. This set of rules is robust and has enabled clearing to come far more into the front and centre, as it should do, and us to be confident that those rules deliver financial stability.

What I would say is that it is not a matter of scale; it is a matter of asking whether we have a set of rules for clearing houses that delivers safety, soundness and financial stability, and the answer is yes.

Q66 **Anthony Browne:** They are part of the latest genesis of this. Clearly, you will not say this but I will: there are protectionist instincts in some European Governments, which, to some extent, is understandable. Their main concern was during the financial crisis, when they felt that they did not have sufficient control over derivatives markets, because so much of it was cleared outside the EU. The regulators have no direct line of sight to those markets.

Andrew Bailey: What that is all about is margining decisions in clearing houses and the question of whether clearing houses are taking margining decisions that are, if you like, sensible in the context. What I would say is that, if you have a robust set of rules for margining, you must follow them through in a crisis. When any clearing house says, "You know what? We have a set of rules, but if we get into a crisis, we want to vary the margining because it is some bit of market in which we do not want to be affected by the margining decisions. We want to get low-cost margining," it does not end well, because you are not following the proper risk management approach.

The answer to that, I am afraid, is that if, as they must, clearing houses have transparent rules and frameworks for margining, you let them operate through crises. In fact, you must do that.

Q67 **Anthony Browne:** Indeed. What lies behind this location policy, as I said, other than that there might be some protectionism, is that there is often concern from EU Governments that, as a single market and an economic entity, they do not have a global financial centre themselves servicing those customers. There is a concern that big EU corporations are having to go outside the EU to raise capital and for their financial services needs. Do you understand that concern from an economic perspective? Is there any reason why an economic entity like the EU should have its own capital markets to serve its own interests?

Andrew Bailey: To use your language, the answer to that is competition, not protectionism.

Q68 **Anthony Browne:** The answer to it is competition rather than protectionism. They should compete.

Andrew Bailey: There is nothing that anybody I know in the UK would do to say you cannot have a financial centre.

Q69 **Anthony Browne:** Absolutely, but that is an approach to get there, and clearly it would be better if they competed their way to having a financial centre of our scale, rather than trying to put up barriers to it, but I am just wondering whether you have any sympathy with the concerns often expressed by EU Governments that they are a major economy without a financial centre servicing it. I am just wondering, from an economics perspective or an economic-ability perspective, whether having the major financial services outside your jurisdiction makes any difference.

Andrew Bailey: I have more sympathy with it as an argument that says—and it has been said post the financial crisis—that the logic for having what they call a capital markets union programme is because, in the financial crisis, there was an over-reliance on bank lending as the form of intermediation to finance companies. I have a lot of sympathy with that, and it was a dangerous concentration. How you get to having a capital markets union is another matter, in terms of how you get capital markets. Going back to the clearing example, what I would say is that trying to put a wall up around it is not going to deliver you a stable outcome.

Q70 **Anthony Browne:** I fully agree with that. My last question is about the prospects for London as a financial centre post Brexit. We are in the middle of trying to agree an MoU, which is clearly going to be pretty high level. Equivalence may do something; we may not be able to get it and, if we do, it may not do that much. I just wonder how concerned we should be about the prospects for London as a financial centre and whether it needs an agreement with the EU to be able to carry on servicing customers there.

Clearly, the EU could put up deliberate barriers, as you mentioned earlier, but there are many other legal mechanisms whereby UK-based financial service institutions can serve customers in the EU, whether by setting up entities in Frankfurt or Amsterdam and doing back-to-back contracts there, or whether by using reverse solicitation, for example, which is commonly cited. Does the UK really need a financial services deal for London to be able to thrive as an international financial centre?

Andrew Bailey: It would be much better if we had a deal, because I believe in open financial markets that operate in a co-operative fashion. I have said before, and I may have said last time, that there is a price beyond which the deal is not worth having.

Chair: That brings us to the conclusion of this session. Could I thank our four witnesses very much indeed for appearing before us again? It is always both interesting and a great pleasure to have you with us, and it has been a very useful, albeit very wide-ranging, discussion that we have had today. A disappointing paucity of knowledge on ballroom dancing has been compensated for by lots of good input on the *Monetary Policy Report* and on monetary policy more generally. Can I also thank you, Andrew, for your typical consideration and courtesy in coming to the Committee with your comments on the issue of equivalence?

As a general takeaway, this is clearly something that Government, yourselves and this Committee will be looking at very closely and taking very seriously. In the event that it moves in some of the directions that we have speculated, I have no doubt that there will be lots of things that we will all be thinking and talking about as a consequence of that. That is probably part of the message that you have delivered to us today. Thank you very much indeed, everyone, for your contribution.