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Select Committee on Economic Affairs

Corrected oral evidence: Quantitative easing

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

Evidence Session No. 9 Virtual Proceeding Questions 86 - 93

Witnesses

I: Adam Posen, President of the Peterson Institute for International Economics, Kenneth Rogoff, Professor of Economics and Thomas D Cabot Professor of Public Policy, Harvard University.

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Examination of witnesses

Adam Posen and Kenneth Rogoff.

Q86 **The Chair:** Two world-class economists are giving evidence to us today: Adam Posen is President of the Peterson Institute for International Economics and Kenneth Rogoff is Professor of Economics and Thomas D Cabot Professor of Public Policy at Harvard University. Thank you both for joining us this afternoon.

Kenneth Rogoff, you have said that QE, "when it consists simply of buying government bonds, is smoke and mirrors". What did you mean by that?

Kenneth Rogoff: Thank you very much for asking me to speak to this Committee and to Adam Posen for joining me here.

In context, quantitative easing has been very important in the middle of crises where the central bank acts as an agent for the Government and is able to shore up markets and prevent long-term scarring, but a point that a lot of people do not understand is that the central bank is a 100% subsidiary of the Government. Its profits and losses are owned by the Government, its balance sheet is owned by the Government, and you really have to look at them integratively. In particular, there are people who think that somehow magically you can create revenue and solve inequalities and climate problems if only the central bank would do more, as opposed to understanding that it is an agent of the fiscal authority. It can do more if charged to do so, but it does not have its own independent balance sheet.

I think this is laid out quite carefully in my 2016 book on the past, present and future of currency. In an excellent series of papers, Ricardo Reis at the London School of Economics also deals with this. I would draw particular attention to one of his papers in the *American Economic Review* in 2013 that makes it extremely clear that the central bank cannot really do anything that the treasury cannot, beyond the usual scenery.

To be precise, in answer to only one question I will, if you permit me, read a couple of short passages from my book in which I explain it. I will try to be concise. I am reading from chapter 8: "A lot of hocus pocus and confusion about the channels through which it has impact surrounds quantitative easing. Superficially at least the basic idea behind this balance sheet game is simple, bearing in mind that the government fully owns the central bank and therefore the central bank's profits and losses. When the central bank executes quantitative easing to buy long-term government debt it is basically shortening the maturity structure of government debt held by the public. That is because overnight reserves are debt of the central bank and therefore indirectly of the government, so QE really swaps one kind of debt for another. By reducing the supply of long-term debt in the hands of the public the government hopes to drive down long-term interest rates as pension funds and insurance companies and other natural buyers of long-term debt compete for a smaller supply of long-dated government bonds, and conversely if they do the opposite. A broader form of quantitative easing"—I mention parenthetically that the Bank of England has done only a little of this—"which virtually every central bank also used during the financial crisis, involves issuing overnight bank reserves (electronic money) to buy private assets. Of course, this practice has a greater effect on the economy because the government is taking private risk on to its balance sheet, an operation that clearly has a significant fiscal element and likely has a more significant effect. Much of the policy literature and virtually all of the popular press label central bank purchases of private assets as QE, but it is more accurately called fiscal QE". I go on to describe how it is a composite of two operations.

"As a rule, at least before the 2008 crisis, central banks in advanced countries were reluctant to intervene in private markets. The crisis changed everything. In the political paralysis that followed, central banks were forced to bear additional problems".

Let me conclude by saying that the core thing, which I think some central banks probably intentionally obfuscate, is that there is not a separate balance sheet.

The European Central Bank is a different animal because there is no central fiscal authority and there are implicit transfers through TARGET2. The meaning of the question you ask is that the central bank in principle is very competent. I supported QE strongly—I wanted central banks to do more—but it is fundamentally a fiscal operation that the treasury could do equally well.

The Chair: Thank you for that answer. I am sure that the book is available on Amazon for those who want to follow on from that.

Adam Posen, do you want to comment? I am particularly interested in the differences between the various phases of QE in response to the global financial crisis and QE in response to the pandemic.

Adam Posen: I thank you, Lord Chair, and the committee for having me. It is an honour for me to be here in the UK virtually and to appear with Kenneth Rogoff, who has done so much seminal work.

My view is that we have to look at quantitative easing as we do most public policies. It does not have a simple mechanical relationship between what you do and what you get as the outcome because you are dealing with human beings, expectations and many factors that you do not control.

What we have learned through hard experience in the UK, US, Japan and, to a lesser degree, the euro area is that there are some facts about quantitative easing. This relates to things that Lord King, Sir Paul Tucker and Sir Charlie Bean and others testified about previously.

First, quantitative easing tends to work most powerfully when a financial panic is under way. It is very good at stabilising markets and compressing spreads.

Secondly, it tends to work best when that panic is severe because it is one that is affecting government securities markets and not just private sector markets.

Thirdly, it tends to work best when it is going up against people who have what James Tobin referred to as preferred habitats, and various others, including my former MPC colleague David Miles, have developed the idea that for regulatory reasons or reasons of self-interest a pension fund or insurance company has to hold certain kinds of assets, and that gives you traction to pivot around those assets to have an effect.

Another point about QE is that it is an imperfect substitute for interest rate cuts, but again—as Ken Rogoff knows better than I do—there is a partial but not heavily dependable effect on exchange rates as a result of QE.

If you put all this together, what it tells you, as we saw roughly a year ago with the co-ordinated central bank action around the Fed and its swap lines at the start of the pandemic, is that when you have outright tensions and lock-ups in liquidity quantitative easing can be extremely effective.

We then have issues about how quantitative easing is or is not effective in raising nominal growth and inflation. There, it seems to be much less dependable. When you get out of situations where there is a financial panic and you are trading along different parts of the yield curve, it seems to be rather asymmetric and you are pushing on a string. Ken spoke a lot about the relationship between the fiscal authority and the central bank. I would also emphasise the ultimate importance of private sector animal spirits and investment, as we saw repeatedly in the 2008 crisis and at times during this crisis.

If something real is happening to the economy, or there is a psychological shock to investment demand—those two can or cannot be related—the ability of QE to move people to invest and consume is limited. Therefore, in the spirit of Lord Skidelsky channelling Keynes, you are pushing on a string many times. Part of the reason that there is so much confusion and frustration about QE is that you can have it moving credit market spreads and liquidity conditions without it having the desired, hoped-for or expected effects on inflation outlook and growth. That is part of what happens. I hope that is responsive to your question, Chair.

The Chair: I turn to Lord Stern to pick up the point on exchange rates.

Q87 **Lord Stern of Brentford:** Adam and Ken, thank you very much for joining us. It is very nice to see you both.

Adam, you mentioned the effect of QE on the exchange rate, to the extent we can work it out. Will you describe what you would expect, with all the usual caveats, the effect of QE on the exchange rate to be, perhaps contrasting what we might see in the UK and in the US and relating it to unwinding QE?

Adam Posen: In some ways, I would prefer to defer to Ken, but thank you, Nick. I think the broad effect of QE on exchange rates comes through its signal about the future probabilities for monetary policy. If you announce QE—generally you announce a programme to buy X billion per month for so many months, or X billion per month until such and such employment, growth or inflation target is met—you are effectively capping what you expect interest rates or the range of interest rate movements to be. This is consistent with the impact of the so-called taper tantrum in 2013 around Ben Bernanke’s statements as chair of the Fed with regard to cutting QE. It was not that they actually directly affected the balance sheet very much, or that they had materially moved credit conditions; it was that people essentially seemed to perceive that the Fed had cut off one whole section of the distribution of possible future monetary policy. That was seen as a tightening, which traditionally would lead to an appreciation of the exchange rate.

Similarly, if the US is on a path where the Fed is trying to campaign to say that it will not raise rates and is trying to persuade people that it will stare down what it perceives to be a market panic on inflation, I would still expect the dollar to rise against sterling, all else being equal, with the usual caveats. Let me leave it there rather than ramble.

Lord Stern of Brentford: I take it that you would expect similar logic to apply to the UK as well.

Adam Posen: Yes.

Lord Stern of Brentford: Ken, would you like to add anything?

Kenneth Rogoff: I can make a couple of points. First, I underscore the difference between fiscal QE and pure QE. When the financial crisis in 2008 happened, interest rates were not yet zero. People thought they would go back up again and QE sent important signals about what the central bank was thinking. That is much less true today because people just think that interest rates will not go up for a very long time, no matter what the central bank says.

It is noteworthy that, if you look at what happened in the US in March 2020, the Federal Reserve initially was doing lots of pure QE, buying government bonds. Markets were collapsing and spreads were blowing up. Then, it simply gave a hint that it will buy a bit of municipal debt-, (which we have not really done since 1840)-, as well as junk bonds and others. It never ended up doing that much. That was transformative—so it makes a big difference.

You ask about exchange rates. Particularly in the earlier period, it certainly could have an effect, because effectively you are lowering long-term rates, and that is very important for exchange rates. I second what Adam said about it not being the same thing as interest rate policy—that is a much more potent weapon—but it had an effect. I know that people in the Bank of England I have spoken to felt this. I do not know so much about the Fed, although there is a recent paper saying that there was an effect.

The European Central Bank is another matter entirely. The single currency was imploding and doing QE was basically having one region support another. That was very helpful.

The Chair: May I say very politely to both of our very expert witnesses that I am hoping to get through eight questions? I know that these are difficult subjects, but if you can help us to get to question 8 that would be great, because while we have you we want to make the best of you.

Q88 **Lord Skidelsky:** I apologise for the technical problems that have rendered me invisible, but I hope that my question will be audible.

Do you think that the Biden stimulus, combined with loose monetary policy, will lead to excess inflation? In answering that, I would be very interested to know what you think excess inflation would be.

Kenneth Rogoff: I strongly support Biden's package and what the Fed is doing. We are unfortunately facing a once-in-a-century crisis. I do not think it is over and the downside risks are considerable. I have looked at model estimates from several sources of what might be going on three years from now. For example, for 10-year US Treasury, which is the world benchmark rate, it is equally probable that the rate will be 1%, 4.5% or 5%. The markets and models are very confused and there is a lot of uncertainty. There are tools to do something about it, but, regardless, this is such a severe crisis that I think the wartime analogy I have used from the start is appropriate. I just do not think it is over.

There is a risk that inflation will be so high because we grow so fast and demand will be so great. This is in a sense the good problem to have out of this. It could be difficult to solve, but I would much rather be facing that than finding out that things will get worse.

As for what is too-high inflation, for a long time I have written that during periods such as this, going back to 2008 and 2009, allowing inflation to go well above target for an extended period would be a very good idea compared with the alternatives.

Adam Posen: I completely agree with Ken on this being a good problem to have and on the normatives, but my forecast is slightly different. Following my colleagues Larry Summers and Olivier Blanchard, the sheer scale of the fiscal policy being undertaken is so great that the US is very likely to have above-target inflation by 2022, meaning somewhere in the mid-threes on headline CPI. Additionally, because there is a lot of micro-data that we can go into about pent-up demand for healthcare, which as you know in the US is very inflation prone and very large, due to a lot of waste and structural problems, we will get a temporary burst of significant healthcare inflation.

The question going forward is whether the Fed is essentially able to stare down markets and say, relating to what Ken said about the Bank of

England in 2008-09, "This is a temporary overshoot and, until it shows up in inflation, we do not react", which is what the Fed has currently committed itself to doing. Whether it will be able, in the face of market movements, to continue to do that is an open question.

I expect somewhat above-target inflation in 2022 into 2023. Along with Ken, I do not believe that that would be a bad outcome, and whether the Fed is able to withhold reacting to it is all to play for.

Lord Skidelsky: In a way, what you are saying is that you would expect to have above-average inflation in a recovery, just as you would expect output growth to be above average. Is that the way markets are likely to see it, because you then get the bond vigilantes and other people saying you must rein in the fiscal stimulus and restrain quantitative easing because inflation is rising above the target?

Adam Posen: I agree with you that that is the risk. That is not necessarily an inflation risk; it is a political economy risk; it is a market communication risk. I think the Federal Reserve is in a very awkward place, because there is nothing it can really say to pre-empt that. I watched Chair Powell basically tearing out his hair and saying, "I have told you repeatedly that I am not raising rates until such and such happens in the labour market". I expect there will be volatility in the US interest rate markets in the next year or two because the market participants—the vigilantes—will simply not accept that, but there is nothing the Fed can do to pre-empt that kind of feeling.

Q89 **Lord Monks:** This question is about the independence of central banks. Professor Rogoff sounded pretty sceptical in his opening remarks about whether central banks were independent at all. To what extent does QE undermine the independence of central banks, particularly in the period that will arise at some stage or other when interest rates have to be raised in the judgment of the central bank, but the treasury of whichever country it is is extremely nervous about the political implications? Is there a real threat to the independence of central banks from QE?

Kenneth Rogoff: This is something that central banks always face when they want to raise interest rates. I do not think that quantitative easing exacerbates this. I am a huge believer in central bank independence. It is just that the instrument of quantitative easing is an emergency action where you are representing the fiscal authority.

On interest rate policy, for now I think that central banks have earned a lot of credibility. You see it in the inflation expectations. There is certainly a concern that in some countries inflation is going to happen. Nevertheless, a lot of very bright people in my country—I do not agree with them—think that central bank independence is no longer needed: that central banks should be reabsorbed into treasuries. You can read articles on that in all the major financial newspapers, including the *New York Times* and *Financial Times*. Plenty of people say that we should have helicopter money and central banks should just do what Governments say. There is a role for co-ordinating the central bank and monitoring the fiscal authorities, but, if Adam is right and inflation goes to 3.5%, we should leave it there for a while, by the way. If the central bank starts to lose its credibility and nobody believes it will ever want to bring it back, then we would have a problem.

Adam Posen: I agree. I think that central banks do have independence. We saw that with the ECB; we have seen it with the Bank of England and the Fed. There are limits to that independence in the sense that you cannot diverge fundamentally from the values of society. If there ceases to be a group in society that cares about inflation, having the central bank be independent is difficult to sustain—but I am hopeful about that.

I remember attending the Federal Reserve Jackson Hole conference in 2012 as I was leaving the MPC. A number of distinguished right-leaning economists at the conference said, "You cannot support QE because it will just anger people and they will turn against the central bank". Here we are, 10 years later, and the Fed has done not only QE but has led an international swap line effort, which was horribly controversial in the previous crisis, and has had no problem politically.

One should not underestimate central bank independence or the ability of it to withstand the use of emergency instruments, as Ken said. However, there are limits. I do not think we are there yet.

Q90 **Lord Livingston of Parkhead:** Adam Posen, you mentioned the taper tantrum, which I think was in the spring of 2013. A few months earlier, in March of that year, at the Federal Open Market Committee, the current Fed chair, Jerome Powell, warned the then Fed chair, Bernard Bernanke, that not giving a clear way out of an ultra-loose monetary policy would mean investors were taking an unnecessary level of risk—it would encourage them to take too many risky bets. Was he right then, and should he be listening to his own advice now?

Adam Posen: I think that he was right in the sense that it is a concern. He is right not dogmatically to take that point of view, because there are other things to balance against it. This is always the dilemma. You have people who are very concerned about asset price inflation, or risk-inducing aspects of QE, and say, "Every time there is an excuse, there is going to be a recession", or, "You are just making the next recession worse".

I think that is a legitimate point of view. On balance, that is probably still not right because, as we saw with Greenspan during the irrational exuberance period and as we saw with the Bank of England in the early and mid-2000s, if you raise rates it does not necessarily end the bubbles that you think you will end. In a certain recession, if you raise rates a lot it is something to be weighed very deliberately. If we care about excessive risk taking, I do not understand why we do not engage in prudential supervision and interventionist regulations. I am very happy to see central banks take on excessive risk taking through that means rather than through the monetary instrument.

Kenneth Rogoff: I agree basically with everything that Dr Posen said. Today, the projections for longer-term interest rates are much lower than they were. I do not think that is because of central banks. That is a big part of why asset prices are so high.

I am a little worried about an uneven recovery that affects sectors differently, parts of different countries differently and poor versus rich countries. An uneven recovery will raise global interest rates; it will happen some day. There are places that are not growing yet. They have not had vaccines and they have had a lot of problems from this horrible crisis. I think that we will have emerging market defaults and many sectors defaulting.

A paradox is that the number of bankruptcies in the United States went down last year, despite this being the worst thing in a very long time. In a way, that tells you that the markets expect a lot of support and if interest rates rise even mildly some of that will not be there—but, as Adam Posen said, you pick your poison. Right now, that is just a risk that you have to take because if you were to raise interest rates it would be a disaster right now.

Lord Livingston of Parkhead: How do we avoid the sequel to taper tantrum—taper tantrum mark II—or do we not care about it at the moment?

Kenneth Rogoff: No, I think that people in emerging markets are very worried about an uneven recovery. They have not begun vaccinating at all yet; some of them entered the pandemic with record debt. The World Bank did a report at the end of 2019.

It is certainly a concern, but the policy that all the central banks—the Bank of England, the Federal Reserve and others—say that they will pursue right now is to wait and wait. They can probably do it better because long-term real interest rates are low.

It is absolutely a concern, but pointing in particular at the profile of interest rates at the moment pushes you even more towards waiting than it would have back in 2013.

The Chair: I apologise to colleagues. The technology has let me down. I know that on Lord Monks’s last question Viscount Chandos wanted to come back on a point.

Viscount Chandos: There are multiple pressure points on a central bank and its independence in respect of going into QE. When the bank’s balance sheet is chock-a-block with longer-term bonds and inflation is rising, which of those matters do you worry about most as a point of stress?

Adam Posen: In terms of a point of stress for independent central banks, there are two worrisome matters. The first is the perception that they are getting into market allocations in a way that is not supported by society. This is what we have seen with the Fed’s unwillingness to implement the so-called main street facility, because this falls under Ken's heading of something that the treasury could and should have done easily rather than ask the Fed to do, which is seen as directly allocating winners and losers.

The second is out of their hands. It is the movements that we have seen in Germany, the UK and US, to varying degrees, of people saying, "We are savers. We are old people who have been prudent. You have kept interest rates down and that is unfair". That is not something a central bank can directly address, but I sometimes think that it has great political potency.

The Chair: Kenneth Rogoff, do you want to follow up that point?

Kenneth Rogoff: I think that Adam Posen said it well.

Q91 **Baroness Kramer:** May I take the conversation in a slightly different direction? I am interested to know your thoughts on the impact of the Fed's QE policy decisions on the Bank of England—whether it drives different choices or provides cover for different choices. I have in mind particularly the Fed's decision last August to shift to average inflation targeting. May I get your thoughts on that from a Bank of England perspective?

Adam Posen: Speaking partly from my experience at the MPC for three years, there are multiple channels through which other central banks, the Fed foremost among them, affect the Bank of England's decision-making, but not in any very direct way.

The simple fact is that the Federal Reserve has an impact on the world's largest economy with the world's deepest markets, so that matters in terms of the economic forecast. There is the aspect of peer pressure and clubs, in a good sense, among central bankers sharing notes and not wanting to be seen to be out of sync on policies, particularly in times of crisis. I think that matters.

In particular, at times of international stress such as last spring, the Federal Reserve and its swap lines matter a lot, but I do not think that there is much in the way of, say, the average inflation targeting move, which is really an ex post label with the Fed simply saying it wants to have an inflation average above target—a go-above target—as well as below. I do not think that has much of a direct impact on the Bank—at least I would not expect it to.

Kenneth Rogoff: I do not think that the Fed is at all a fashion setter when it comes to inflation targeting. New Zealand has had a bigger impact. The Bank of England has had a much bigger impact than the Fed, from its fan charts to the many ways it has done inflation targeting.

On the other hand, if we are talking about interest rate policy, the Fed's weight is greater than all the other central banks combined. It is the dominant currency; it is more so than ever. I do not know whether that is a good thing. We could discuss that. Its policies matter a lot, but in terms of finding the right way to manage monetary policy the Fed has really followed other central banks.

If we think of future innovations—negative interest rates and keeping very low long-term real interest rates today—the Fed will not be the leader; it will be other countries.

Q92 **Baroness Kingsmill:** Professor Rogoff, I am interested in your analysis of the relationship between treasury and government and central bank. Do you think that the central bank has any responsibility to measure its effectiveness with QE and the distributional impacts, or is that the responsibility of government?

Kenneth Rogoff: Of course, the central bank needs to care about whether QE is effective since it is doing it and because of its role as part of government. Monetary policy has huge distributional effects.

There are many aspects of monetary policy. There is regulatory policy. If we are talking about interest rate policy, I would say that the distributional aspects are better addressed by the Government than by the central bank. Let me pick a stark example. This crisis has disproportionately hurt a sector of the population very badly—service workers, low-income workers and women. Amazon does not really need a zero interest rate; it is part of the reason its stock is so high. It does not need that help. That kind of targeting is much better done by fiscal policy.

On the other hand, any time the central bank is making a major policy shift, it always needs to think about the distributional effects, because they might not be undone by the Government in any short order.

Baroness Kingsmill: That is exactly what I am referring to—the political implications: for example, inequality. QE is seen as a means by which asset prices rise. Quantitative easing affects the stratosphere as opposed to the real economy. Theoretically, it is supposed to have a trickle-down effect, but it appears to many to have a very serious negative distributional effect, as you point out, in terms of inequalities. Adam Posen, do you want to add anything to that?

Adam Posen: In line with something that Ken said earlier regarding the determinants of interest rates, while what you say is true, a fundamental at work here is that vulnerable and poor people who are discriminated against will always be worse off, whatever happens.

Baroness Kingsmill: Yes.

Adam Posen: Part of it is that, even if you stop QE and it has any contraction effect on the economy, it will disproportionately affect them. I am not suggesting you do not know that. I just want it to be on the record that the perceived inequality partly reflects an actual inequality and is neutral with respect to whichever instrument you use.

Baroness Kingsmill: It is sometimes my role in this committee to bring things back to the realities of how these things affect everyday life: the common person, or the real economy, as it is known.

Q93 **Lord King of Lothbury:** I would like to ask Professor Rogoff and then Dr Posen to comment on the following. Ken, when you talked about the economic consequences of QE, you stressed that it was important to look at the balance sheet of the public sector as a whole but, when it comes to the policy decisions that affect that, it makes sense to distinguish between an independent central bank and the treasury. It might seem natural that decisions on interest rates—what you describe as pure QE—would be for the central bank, but decisions on what you describe as fiscal QE would be for the treasury. The central bank could be the agent, but the decision is taken by the treasury.

I would like both of you to comment on that. Will you also say something about the appropriate governance arrangements for decision-making on QE in these various guises?

Kenneth Rogoff: The central bank in a crisis can certainly act very quickly in a way that the rest of the Government may be able to in principle, but often cannot act fast enough. The central bank has the expertise and it often has the information to make these very quick decisions. Having it charged with dealing with financial stability and giving it a broad remit to take care of things is very important.

On the other hand, let us take climate change. I favour a carbon tax, and I suspect you do as well. This is a very slow-moving problem; it needs to be dealt with together with the Government. The central bank has quite a bit of expertise, but so do universities and the Government, and it is important to distinguish these cases.

I strongly favour—I know that you disagree with this—taking steps to bring interest rate policy back into central banking if interest rates stay this low. That is a topic for another day. Pure QE today when there is not a crisis is not doing much at all. All the evidence is pointing in that direction. Fiscal QE is fine in supporting the private sector. We need to let go very slowly here, because the statistic that there were fewer bankruptcies in 2020 than the year before is telling you that there is a lot of support in the system and you cannot just drop it all at once. That would be a disaster.

As for choosing sectors and winners and losers, it depends on the country, but certainly in the United States and, as I understand it less well, in the United Kingdom you have democratically elected bodies and others to think about these questions. There are countries where the central banks are very integrated with Governments and they report to the treasuries and make a lot more political decisions.

Adam Posen said at the beginning that, in a financial crisis, or any kind of crisis, there is no substitute for having this agent of the Government being able to act really quickly. If I may use a military analogy, maybe ignorantly, the US Marines have about a tenth of US armed forces, but they can move really quickly and often go first into a situation—but over the longer term the rest of the armed forces need to take over.

I think that is the case when the central bank is executing fiscal policy. For all the mass of interventions that central banks have done, it pales next to the amount of debt that Governments roll over every year. If government wants to shorten the maturity structure of debt, it has plenty of opportunity to do that, so we just need to distinguish between the short run and long run.

Lord King of Lothbury: Before we turn to Adam, may I say that during the financial crisis I remember Tim Geithner saying to me on many occasions, "You have a real advantage in having a parliamentary system because government can act very quickly, whereas in the US Congress takes for ever"? Does that affect your judgment on the relative distribution of decision-taking between the two bodies in different countries?

Kenneth Rogoff: Quite honestly, it does. There is more capacity to do things with the British Treasury quickly than there is with the US Treasury. That said, the Bank of England has enormous expertise in dealing with financial markets; it has more information at its fingertips and has its ear to the ground all the time in ways the Treasury does not. These things need to be acted upon quite quickly. In principle, you would like to have excellent staff and technocratic help at both institutions.

When I first became a PhD student in the mid-1970s the US Treasury was great; it was the one thinking through moving from fixed to flexible exchange rates; a lot of the leading thinkers were at the US Treasury. I do not want to say that there has been a 100% change, but a lot of the expertise has migrated to the Fed, which puts it in a better position to make decisions quickly.

Adam Posen: I agree with Ken, basically. You raised the critical issue of governance. A lot of promise has been shown recently in the Bank of Japan, and in the past in the Treasury-Fed accord in the US in the 1930s through the 1950s in what is called yield curve control: the idea that the central bank targets a particular piece of the government yield curve and limits movement in that rate if there is the occasion and public support for the continued financing of the treasury. To me, this is a good thing if you are to take this route, because it allows the central bank to stay out of the specific allocation of fiscal matters between various purposes and at any point to say, "This is no longer consistent with our goals. We will pull out and stop doing yield curve control", or, "We will raise the target on yield curve control".

You can always say that if they are not independent they will abuse this, but, on the assumption that in the democracies of the UK and others that we are talking about the central bank would be respectful and independent, I think this is a good governance format.

Lord King of Lothbury: Let us assume that we have reached the point where we feel we are coming out of Covid-19 and things are recovering, and central banks begin very gently and slowly to tighten policy from this exceptionally loose position. Do you think that they are more likely to do that, and should they do it through increasing interest rates or unwinding QE?

Kenneth Rogoff: I do not know the answer to that. I suspect that most central banks have been saying that they intend to unwind QE very, very slowly—let it run off and not do lots of operations in the other direction. If you think of it as a maturity transformation, the treasury can lengthen the maturity structure of government debt without any action from the central bank and it will not confuse the markets. It is more likely that it will be interest rate policy.

I have seen forecasts. Who knows? The forecast of the market at the moment according to many models is that we will not see interest rates, policy rates, rise from zero until well into two years, maybe three years, from now.

I see Charles Goodhart online as a future witness. I would commend to everyone his great recent book pointing out that inflation is really low now, but that is in part down to factors such as globalisation, which could change. There are reasons to think it might. I wrote a paper for Jackson Hole in 2003 called *Globalisation and Global Disinflation*. I think I got about a quarter of the argument that he has right. It is worthwhile looking at that if we are so confident that we know what happens next.

Adam Posen: Lord King knows that when he was Governor and I was serving on the MPC the decision was taken at the Bank of England that if and when we tightened, which we hoped was much sooner than it turned out to be, we would raise rates first because that was the dependable and very transparent fast instrument, and any changes to the balance sheet would be done over a longer period, with consideration being given to avoiding crossed wires with management and disruption of markets by moving the balance sheet. I have seen nothing since that time to cause me to change that prioritisation.

Lord Bridges of Headley: I want to pick up briefly what Lord King was getting at in referring to the exit strategy. In having this debate, how concerned should we be that we do not know the exit strategy and endgame?

Kenneth Rogoff: It is hard to know the exit strategy when we do not know what is going on. A big shock such as this pandemic leads to unexpected changes. You certainly do not want to announce too much of your exit strategy when you do not know what you are exiting into, but if we are just talking about tightening monetary policy, when that happy day comes, we need to think hard about that because hopefully it is because our economies are doing so well, not because Asia is booming and somehow that is pushing up global rates. Hopefully, we are doing well.

I think that the likelihood, to follow what Adam Posen said, is the decision taken a long time ago by the Bank of England to try to exit through straightforward interest rate policy. It will be a very good day for central banking when that is the nature of monetary policy again. If we do not have an interest rate rise we need to think hard about how to make negative interest rate policy effective, which I think it can be, but not under current institutional arrangements. If we just have inflation going up and upward pressures around interest rates—hopefully they will ascend slowly—I would tread very carefully, because the potential for financial mess with all the support that has gone to the private sector—I am not talking about the fiscal stimulus but all the indirect credit support—is just enormous.

The Chair: Adam Posen, do you want to respond?

Adam Posen: I yield my time to what Ken said.

The Chair: Kenneth Rogoff and Adam Posen, thank you. That has been a fascinating session. We are extremely grateful to you for joining the committee. Your answers have been clear. From your evidence, there are at least two books on Amazon that need to be bought by the committee. Thank you very much.