



Select Committee on Economic Affairs

Corrected oral evidence: Quantitative easing

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4 pm

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

Evidence Session No. 12

Virtual Proceeding

Questions 112 - 124

Witness

I: Stephen G Cecchetti, Rosen Family Chair in International Finance at the Brandeis International Business School.

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Examination of witness

Stephen G Cecchetti.

Q112 **The Chair:** I welcome you, Stephen Cecchetti, to this second session of the Committee. You are the Rosen Family Chair in International Finance in the Brandeis International Business School.

I will ask the first question. Following on from the discussion we have just had, do central banks require new mechanisms of accountability if their mandates are expanded, and what recommendations would you make to do so?

Stephen G Cecchetti: Thank you, Lord Forsyth. Let me start by saying that it is an honour to have this opportunity to contribute to what I see as a very important and timely inquiry. Yes, I think central banks need distinct mandates and accountability for what they are doing, and in particular for the four ways I would list in which they can use their balance sheets. These include monetary policy that is aimed at aggregate demand management, which includes QE; addressing liquidity problems in specific markets as a market maker of last resort; acting as a lender of last resort to solvent intermediaries that are facing immediate liquidity needs—this may go beyond banks; and steering credit to particular firms or possibly sectors or industries. Each of these can involve an expansion of the balance sheet of the central bank and therefore increase reserves, but they are distinct. I think we need to keep them separated at least at some level.

In recent years, central banks have done all these things. If you go, for example, to the website of the Federal Reserve, you will see a listing currently of 17 active monetary policy tools. There may be more, but they list 17 of them. You can go through these and try to categorise them according to which of these four activities they are involved in. My rough accounting, and people might disagree, is that five of them are primarily for monetary policy, two are as market makers of last resort, five as lenders of last resort and five are for credit support. Surely things can bleed from one of these categories into another. The March 2020 purchases of Treasury securities by the Fed started as a liquidity operation as a market maker of last resort for the US treasury market, surprisingly to many, but has shifted over to stimulating aggregate demand.

Over the past dozen years, central banks have taken on a series of new roles and they have done this, unfortunately, in my view, without clear mandates. I think they need mandates and they need clear governance and accountability mechanisms for what they are doing. Fortunately, I think we know how to do this, because we have done it very well for what I would quaintly call conventional monetary policy in the pre-2008 world. The system that set up in the Bank of England in the mid-1990s could serve as a guide. There are two parts to that system, in my view. One of them is a robust, internal decision-making process and the other is public transparency. You have in the UK system an informed committee in the

case of standard monetary actions; it is the Monetary Policy Committee that takes decisions. This is done by committee rather than by individuals. I think that adds robustness to the process. Then policymakers explain themselves in public through various public statements, publications like the inflation report, and the Governor's press conference.

Explaining what you are doing, why you are doing it and, importantly, how what you are doing is achieving the goals that the elected officials have given you proves both to make the policy more effective and to make you accountable. As I suggested, experience in the pre-2008 period suggests that this system from the 1990s has worked quite well, so why not just copy it and copy a successful framework over to these other activities?

Balance sheet decisions should be made by a statutory committee to provide a public explanation of what you are doing, why you did it and how it furthers the goals that are set out in your mandate, and to say whether this particular action served as an aggregate demand stimulus or dampening of aggregate demand, which we would think of as conventional monetary policy that is designed to achieve an inflation target?

Was it a market maker of last resort operation that was put in place because of short-term illiquidity or disruptions in particular markets? Was it a lender of last resort action or was it a credit support operation? Should new mandates come along—I can envision some—assign the relevant policy tools to a committee and require a public explanation.

The Chair: Very briefly, do you have a view on the best practice for making central bank appointments accountable and transparent?

Stephen G Cecchetti: For making the appointments themselves, for instance the Governor and the like? I have not thought about the appointment process. I have always viewed the appointments as being the one time when the politicians get to have their say and put in the people they believe to be the appropriate ones. I think that in a representative democratic system that appropriately belongs to our elected officials.

Q113 **Lord Livingston of Parkhead:** Stephen, thank you very much for coming. One of the rules of the central bank was to help drive the market, particularly QE, to change market behaviours. However, we have seen with the taper tantrum and with some of the reactions when the ECB has suggested that it will not support certain countries who have become riskier than, let us say, Germany, that the market has bitten back pretty hard. Have we now seen the shoe going on the other foot and it is the central banks that are now prisoners of the markets rather than the central banks driving the markets?

Stephen G Cecchetti: That is an important concern, and it is definitely always a risk. In the current circumstance, as you suggest, stopping or

reversing existing bond purchase policies can really lead to volatility. But assuming that the policies were correct in the first place—I guess I will give them the benefit of the doubt on that—the possibility of future volatility should not constrain what central banks are doing now to try to meet their objectives.

Suppressing volatility is not in the mandate of the central bank. It can be a side effect of certain actions, but given that their objectives are generally things like low stable inflation, or in some jurisdictions possibly adding employment or growth objectives, suppressing volatility for its own sake is not something you should do unless it is a threat to price stability or financial stability.

Importantly, central bank actions have pushed investors in recent years into higher-risk assets and encouraged accumulation of leverage. This as an intended consequence of their policy to try to stimulate aggregate demand. They can create financial stability down the road, but the fact that they could create financial stability in the future does not mean that central banks should tighten policy today to address those possible future financial stability risks. Instead, I think this problem belongs with your Financial Policy Committee, for example, as well as with macroprudential authorities in other jurisdictions. They have tools and powers that exist to ensure that the underpricing of risk and the build-up of leverage that may come as a consequence of these quantitative easing policies of various kinds do not lead to financial instability.

Q114 Lord Livingston of Parkhead: I think we have a question later on that very point. Moving to a related point, one of our previous witnesses talked about the co-dependency between the markets and central banks, basically meaning that they are acting in their own bubble and somewhere off in a different place as the real market. Is that something that you recognise? Should it be broken, can it be broken, or is it just a fact that QE in particular, and non-conventional monetary, does that?

Stephen G Cecchetti: It is an important observation and one that you definitely have to keep in mind when you are engaged in these policies. But it is certainly also the case that those sorts of disconnects can exist without the central bank doing what it is doing today. Recalling the actions of the 1990s, for instance, the central banks were not providing the impetus, at least not in my view, for what became the dotcom boom and bust.

Again, keep your eye on the target, on your mandated objective, and your policy should be measured against that. The risks that come from asset price booms, especially assets where there is a lot of leverage involved, the responsibility for dealing with the potential financial stability risks and systemic risks that arise from those should belong to someone besides the monetary policy authority.

Q115 Lord Monks: Following on from Lord Livingston's question and the discussion you had with him, QE's purpose is to stabilise and calm markets in a period of volatility. Yet some of the critics of QE we have

had before us have suggested that it can have the opposite effect and destabilise markets, with cheap money being generally available and channelling that cheap money into asset purchases that, among other things, promotes inequality. Is it a distorting mechanism, in your view? Are you worried about some of the possible adverse consequences that could come from it?

Stephen G Cecchetti: As you rightly point out, QE, in its action as market maker of last resort, has done some very good things. I would point to the aftermath of the Lehman bankruptcy in the autumn of 2008 and winter of 2009, as well as the actions in March 2020. In both cases, actions to intervene or backstop markets and to intervene and backstop intermediaries that themselves were making the markets helped to stabilise the system. Yields and spreads stabilised, and volatility dropped. But, as I think you suggest, there are a few consequences of this in the medium term, and possibly even in the shorter term, that arise from search for yield. I would add to that also the potential for the distortion of price signals.

On the first of those, there is a concern today again that the stability that we have created will lead to future instability. My former colleagues at the BIS, where I spent time in the last decade, are famous for this, and they may be right, still. But I do not know of a reliable model or structure that embodies the trade-off between what I would call a risk of a meltdown today and a reduction in the risk of instability at some indeterminate future date. Maybe that trade-off is there, but lacking a model, and more importantly a calibration of such a model—remember that policymaking of this sort is about numbers—I would be reluctant to act.

On the second of those, I think there is another concern that comes directly from your question. When you support markets, you distort price signals. This has a couple of implications. First, it can become hard to know whether or not you are distorting resource allocations as you distort price signals. Prices are supposed to tell us how to allocate resources. You could be making this worse or better.

A second and possibly more immediate problem is that you distort the information that we get from prices. Let me give you an example of something that I think is somewhat of a concern right now. The Federal Reserve today holds very large quantities of both nominal and index bonds. It has intervened in both those markets. We like to measure market-based inflation expectations by taking the difference between those two. We subtract the index bond yield from the nominal bond yield, say, for the 10-year benchmark or something like that. However, if you are massively intervening and own 30% of the market and are buying every week, the question is: can we trust the signal that we are getting for that, or is your intervention distorting prices and making what you think is a signal that inflation expectations in markets are anchored at your 2% roughly longer-term goal? Are central banks distorting those?

When central banks operate as market makers of last resort and as lenders of last resort, that is clearly stabilising. The best way in which the longer-term risks of instability in this sense can be recognised, and hopefully controlled, is through the sort of framework that I just outlined, where you have a clear mandate, a robust decision-making process and public transparency about what you are doing and why you are doing it.

Lord Monks: Are you worried about rising inequality because of the effect that QE has on asset prices and so benefits the holder of assets? Is this a problem?

Stephen G Cecchetti: I am always worried about rising inequality. That is the short answer to the question. I am particularly worried about the wealth inequalities that are being created and how they feed into income inequality. I am not sure that there is much that central banks can do about that, but I worry quite a bit about the political implications of that. I should leave the politics to all of you; that is not my expertise. But I can tell you that when I was involved in the financial regulatory reforms in the aftermath of the financial crisis of 2007-09, there was a serious concern that the next time this happened there would be riots in the streets. I think that the populism that we are seeing is a part of that. Yes, I am worried about that, but I am not sure that I am in a position to give you advice on what to do about it.

Q116 **Lord Skidelsky:** Professor Cecchetti, QE has gone a long way beyond market making and lender of last resort. It has been in continuous operation outside emergencies. How worried are you that countries with high levels of debt and large central bank balances risk a return to sustained inflation? To what extent are high levels of fiscal debt and bank balance sheet correlated?

Stephen G Cecchetti: Starting with the issue of inflation, events of the past year have surely increased this possibility. Just to be clear, this is not about short-lived bursts of inflation where inflation would rise to, say, 3% for a year or two. Such a burst would likely be welcome, especially in jurisdictions where central banks have had a hard time getting inflation up to their target, which in most cases is in the range of 2%. Where there are fears over inflation rising to 5% or more, that possibility is very bad and its likelihood has clearly increased. To understand why it has increased, I would like to think for a second about the consolidation of the balance sheet of the Treasury and the central bank.

This is a thought experiment for the purposes of logic, not governance; the two balance sheets are still governed separately. In thinking about that, it is important to keep in mind that what QE does is convert long term fixed-rate obligations into short term, overnight floating rate obligations. It takes long-term sovereign bonds and makes them into interest-paying reserves. As you point out, Lord Skidelsky, it has done this now for some time and the accumulation has been large. This shortening of the maturity structure of privately held debt seems to me, in the current circumstance with very low long-term rates, to be pretty poor debt management policy. I will just put that out there.

That poor debt management policy has implications, because the structure creates a risk of what economists call fiscal dominance, where raising short-term rates increases government financing costs. As others have said to you, it creates the risk that the central bank will start running a cash-flow deficit, if you will, and will start eating into the capital or equity of the central bank.

We can have a separate discussion about whether central banks need to have equity at all. As an economist I come at that and say, "Equity does not really matter. Who cares, because this is part of the Government and this is just an accounting thing", but on a political level it is extremely important, and so that matters quite a lot.

This creates a circumstance where political pressure for the central bank not to raise interest rates can arise for two reasons. One is the status of its own balance sheet. The other is the fact that if it raises interest rates, it raises the financing costs for the Government. With debt levels that are approaching or are over 100% of GDP in major advanced economies, this is not a trivial concern.

Assuming that the economy recovers, though, keeping short-term rates low becomes self-defeating, and this is where the inflation comes in. If you do try to keep the interest rates low, you will get inflation. That will drive interest rates up. This makes the government financing problems worse. Alternatively, if you start raising interest rates, it hits government financing. This is exactly why we value central bank independence and why we want independent central banks that have the capacity to take a longer-term perspective that maintains price stability.

We have to make sure that the central bank's relationship with the Government is not such that that independence is compromised. I want to make sure that I am clear that it is not about legal or de jure compromise of their independence; it is about the de facto compromise of their independence, where the central bank is forced into doing certain things just because of where they stand with their balance sheet and what they have done in the past.

Q117 Lord Skidelsky: You have talked about the effect on central banks' balance sheets. When a central bank says that it will not tighten policy until inflation is staring them in the face, suppose inflation does not stare them in the face. In other words, suppose that its policies do not produce inflation because they have minimal impact on the real economy, which has been suggested to us. Do we face QE for ever? Is there no way in which it can be curtailed? The policy does not work in terms of its inflation target, so you go on until you reach the inflation target, but you never reach the inflation target.

Stephen G Cecchetti: This gets into some of the other questions. We need a framework for understanding what is going on with QE.

Lord Skidelsky: I agree.

Stephen G Cecchetti: I will answer your question directly by saying that I hope that does not happen. I also believe that it is unlikely to happen, because, at least in the current circumstance, fiscal policy has stepped in with sufficient aggregate demand stimulus that it seems to be likely that inflation will come. There are differences of view on how much inflation will come, when it will come, where it will come. But where I am sitting right now (in Lexington, Massachusetts) there is a very vibrant and vocal debate over whether or not the most recently passed US congressional action to try to stimulate aggregate demand will result in inflation. If that were the case here, I think we could be fairly certain that what the Federal Reserve is doing will stop and it will have to do something about it, at least eventually.

Lord Skidelsky: In one sentence, your conclusion is that fiscal policy will rescue the balance sheets of central banks?

Stephen G Cecchetti: In some jurisdictions I think that is right, but I think it is very important in circumstances like the ones that we have found ourselves in that central banks are not the only ones out there; that, as others have said, they are not the only game in town. When central banks have reached the end of what they can do for aggregate demand, fiscal authorities need to take over if that is what is appropriate for society.

Q118 **Lord Bridges of Headley:** I will build on your last comment and bring you back to one of your central points about the need for public transparency. You said that central banks need to set out what we are doing and why we are doing it. Would you not add to that list the end game—how we are going to unwind this—and set that out very clearly? Building on that, if they do not do that, how worried should we all be, and what risk does that pose to financial stability?

Stephen G Cecchetti: I guess the one-word answer to the question at the beginning is yes. We need clarity and transparency about short-term policy paths, as well as what I would call medium and long-term plans for restoring sustainable settings to all policy tools. Appealing to the comparison I made at the beginning, central banks do this regularly, or have, with interest rates. They tell us their plans. The Federal Reserve, on a quarterly basis, issues its expected future path of interest rates. It is possibly a bit difficult to decode; this is referred to colloquially as the dot plot. But the Federal Reserve does this and then people can take issue with it.

Why should policymakers not do this with balance sheet policies? Why should it be any different? All of the four policies that I mentioned to you presumably should not live forever, and given that central banks have engaged in these large-scale operations now for over a decade, they surely have some model for how their balance sheet policies influence the forecasts of their mandated objectives. They should tell us. We do not have to believe their models. We do not have to agree with them, but they should be telling us. They should also tell us why they are choosing the scale of activities they are choosing. For example, why is the Federal

Reserve buying \$80 billion a month worth of Treasury securities and \$40 billion worth of mortgage-backed securities rather than more or less of each of those?

Doing that would reduce uncertainty. In the production of their forecast, the central banks should tell us what is going to happen to QE as the economy recovers. That should be a part of the policy framework where they give us a clear view of the medium and long-run size and composition of their balance sheet.

In the current circumstances, as the economy recovers policymakers should answer your question: what is going to happen to QE? The best assumption cannot be that it will continue on as it is for ever. Central bankers have gone to a lot of trouble to explain their interest rate reaction function—how their interest rates will change when economic conditions change. How will they react in terms of their balance sheet policies when conditions change? They should do this for all their tools. Ultimately, this is not just transparency, it is also accountability. Markets should then respond to news about the economy, not to news about policymakers.

Lord Bridges of Headley: How serious an impact is this lack of clarity on exit strategy on financial stability? Should we factor that in?

Stephen G Cecchetti: Here we can look to the history of the last few years and see that when there are announcements, because the announcements are not very frequent they are disruptive. I think is a concern. Central bankers, in making their policy, should have as a goal that the reaction to their statements is muted. In my ideal world, central bankers speak and everybody yawns, because they already knew what would happen. But when data are released, that is a different story.

Q119 **Viscount Chandos:** Professor Cecchetti, before I come to my planned question, picking up on your comments about the importance of having a framework for understanding QE, you also referred a number of times to the role of the central bank as a market maker of last resort. Would it be feasible, and would it improve transparency, if we separated the programme of market maker of last resort purchases from other QE purchases?

Stephen G Cecchetti: There are two issues that may be separable. One is about decision-making: who decides what, and who says what. The transparency and the announcement should clearly be different, but who decides is a more complicated issue. I think about the Bank of England system that was set up in the aftermath of the financial crisis, with what look like three interlocking rings. I am agnostic about whether you put those into one of the existing rings or create a whole new one.

You need to have clarity about what the exact tool is and who is making the decisions. Then you need to make an announcement about it and that announcement should make clear the type of balance sheet policy you are engaged in. The rest of it is words and rhetoric. What you decide to

call QE and what you do not is much less material than explaining which one of these you are doing.

Q120 Viscount Chandos: Has the Fed's approach to purchasing corporate bonds, and particularly high-yield bonds, has led to any favourable outcomes in the real economy, in comparison to the Bank of England's greater concentration on buying gilts, straight government bonds?

Stephen G Cecchetti: The honest answer is that I do not really know. We can view the corporate and municipal bond purchase programmes that the Federal Reserve has been involved in from one of two perspectives. They are either market maker of last resort operations that were designed to provide liquidity to corporate and municipal debt markets during the period of heightened market instability, or they were operations to steer credit to the issuers of those bonds, or some combination of the two.

Because they remain small—and I will come to exactly how small in a second—it is primarily, in my view, in the first category as market makers of last resort. It is important to keep in mind that in the case of all these corporate and municipal bond programmes, none had any reported assets prior to mid-June 2020. They were announced in late March, but they had no assets until mid-June, and at their peak they had only \$20 billion. That was the amount at the end of last year before the then Secretary of the Treasury Mnuchin announced their intent not to reauthorise the programmes.

In that sense, however, these programs worked at calming markets, and did not involve vast amounts, so this is an important lesson about market makers of last resort. They provide a signal, but to provide that signal the backstop they are offering has to remain large. These two programmes combined had an authorisation of US\$1.5 trillion, but as I said they only had a maximum outlay of \$20 billion and it is not even clear they needed to do that. But they were effective, so it is clear that you need this capacity and if you have it, you may very well not have to use it. In this sense, they are very different from the Bank of England's large-scale government purchase programmes. They are quite distinct, with a very different set of objectives, so I am not sure I would compare them.

There is another set of programmes which you did not mention, which are the Main Street lending programmes of the Fed, and I will touch on those for a second. Those are clearly credit support programmes. I am not a fan of them, because they are fiscal operations. They remain small for a variety of reasons. I would have been a far bigger supporter had the Federal Reserve copied the UK Government Bank of England Funding for Lending programme. Not only does that joint programme make it clear that it is fiscal in nature, but it subsidises banks to expand their lending. It strikes me as targeting marginal borrowers in just the right way and operating through the banking system, which is a better way to go. It also has clear governance and accountability lines that make a lot more sense to me than the mainstream facilities that the Fed has set up.

The Chair: Thank you, Professor Cecchetti. We are getting quite a lot of compliments from people from outside the UK for the Bank of England, which is gratifying.

Q121 **Lord Fox:** Coming back to the Fed and perhaps what we can learn at this end, to what extent is the Fed's new monetary policy framework a model for what other central banks should follow—or perhaps one that they should not follow, depending on your response?

Stephen G Cecchetti: I will go with the second.

Lord Fox: That is probably where you are heading.

Stephen G Cecchetti: Thanks for the opening. I would say probably not. The Fed's new framework has two parts that are obviously related, but we can describe them distinctly. It has labelled the first one "flexible average inflation targeting", which has an unfortunate acronym. Flexible average inflation targeting is the idea of allowing inflation to run high for a while after it has been below target to make up for past misses and to keep the price level on track. Monetary economists refer to it as price level targeting, a much less unwieldy term.

There is a second part to what the Fed has announced in their framework, however. That is a shift from a symmetric concern about deviations of unemployment from the perceived level of a long-run sustainable level to an asymmetrical concern about shortfalls. The first of these, the shift to flexible inflation targeting, it strikes me is not novel at all. Here the Fed is much more of a follower than a leader. Other central banks have done things like this, either explicitly or implicitly, for some time. The change in its concern over unemployment is specific to the Fed's dual mandate, and since other central banks have hierarchical mandates, with price stability coming first, it would not make sense, in my view, that they would adopt this.

Interestingly, I will point out that if you look at the history it is almost surely the case that the change in the treatment of unemployment will have a bigger effect on actual policies that are put in place than the flexible inflation targeting. Also, the new framework strikes me as quite complicated, both to execute and to explain, in addition to relying on some fairly idiosyncratic characteristics of the United States system.

For those reasons, I do not think that others would want to copy what the Fed has done.

Lord Fox: You seem to be saying that the Fed has a much more overt industrial strategy role. Is that your view? If it is, what are the consequences of that role?

Stephen G Cecchetti: It is industrial strategy in the sense of caring explicitly about employment. It is not what I would label an industrial policy, which is more about the distribution of resources across the industrial sector. It does not do that. I am concerned that it is starting to

do that; that there is directed credit in some of these policies. In a representative democracy, I believe those are ill-advised.

I think the Fed has learned in the last decade or so, or possibly less, that it seems to be possible to push unemployment rates lower than it thought was feasible without setting off inflation. That is the source of this change. I would not have thought that unemployment rates below 4% were possible before it happened, and I have been in this business for 40 years, I am afraid to say.

Given that, I think you have to be chastened, if you are the central bank, which has a dual mandate like the Federal Reserve's, into thinking that you should possibly start tightening policy when unemployment hits some higher number just because you think that inflation might be down the road.

This is almost surely going to lead to an overshooting of inflation, but it is one that the Fed can explain in the context of its trade-off. For the Fed, it makes sense. I can easily imagine it letting inflation expectations rise above its 2% level with an eye towards lowering unemployment and keeping it there. The Fed would then, of course, also have to raise its longer-term goal, which it might do—it sets that goal—which would effectively change the inflation anchor in the United States above where it is now. I would not expect other central banks to do this on their own.

Q122 Lord Fox: That is a good lead-in to a broader view of central banks. Are they increasingly being asked to shoulder increased responsibilities, perhaps responsibilities that are beyond their direct power and beyond their remit? Do you see that as a trend or is it just happening?

Stephen G Cecchetti: It may be a trend. I hope it is not a trend in the sense that it has come into vogue in places that are trying to copy what the big guys are doing. That would be unfortunate. I think it is a trend that arose in part because central banks were backed into doing things they might not otherwise have done.

If you are a central bank governor or a policy committee in a central bank and you see things happening in the world that are potentially disastrous, everyone might agree that the fiscal authority, the parliament or the congress might be the better suited to addressing the problem. Others' policies might be more appropriate in the circumstances, but they are sitting on their hands for one reason or another, and you are not also going to sit on yours.

I think that has driven the Fed into this. It has changed people's expectations of what central banks can do in ways that are unfortunate, and I think it creates risks that central banks are being trapped now into trying to do things they cannot do. If you will indulge me in quoting Lord King from his final BIS enterprise, I can see he knows what I am going to say. At the time he was a few weeks from leaving office and he sat there and said, "If the central bank is the only game in town, I'm getting out of town". I completely understand the feeling, and I think that many of his

colleagues certainly shared that feeling then and I am sure a number of them do now.

Lord Fox: Thank you. That is very helpful.

The Chair: We are very glad that Lord King is still in town and on this committee.

Q123 **Lord Haskel:** You have spoken about transparency, but you have also said why government and central banks need to co-ordinate policy during the pandemic. Has there been sufficient transparency, clarity and clear boundaries during this co-ordination?

Stephen G Cecchetti: This is an extremely difficult and very important question. I also think the answer is no, at least not now. First, everyone agrees that, during a crisis, co-ordination across all parts of government is essential. I would subscribe to the wartime analogy in what we have seen over the past year. But, at the same time, it is important to think through the long-run implications of what you are doing. We keep returning to this point about central banks buying large quantities of government bonds. You are helping the Government, you are helping the economy, but it is leaving you in a worse position, given that you did not lock in very low long-term funding rates.

The question is how to ensure the central bankers can co-ordinate with the Government during a crisis in a way that allows them to return to being fully independent and using their tools to meet their policy mandate once things calm down. Part of the answer to that is improved transparency, and here I would say in different jurisdictions it will work in different ways. This means explaining co-ordinated actions very clearly, and it is particularly important in the case of certain kinds of debt management operations.

Let me give you an example from the United States, the case that I know the best and probably one of the reasons why I am sitting here speaking with you. Early in the pandemic the Fed purchased Treasury securities faster than they were issued. The Fed essentially prefunded the Government. This is not well known, I have to say, unfortunately, and that is part of my point. The amount was very large, and I am used to looking at some pretty big numbers. Over a four-month period, the Fed purchased enough securities so that the Treasury's account at the Fed rose by \$1.4 trillion, so that by July 2020 it was at \$1.8 trillion. The \$300 billion-\$400 billion number is a steady-state number from the pre-pandemic period, and it rose by \$1.4 trillion.

Since early February of this year, over the past six weeks roughly, the Treasury has drawn down its balance at the Fed by \$540 billion—also not a small number, if you ask me. The Federal Government is very big, the Fed is very big, but \$540 billion, however you measure it, is a really big number. The important thing to realise is that this is going directly into commercial bank reserves. This is the US Treasury engaging in monetary policy.

I challenge you to find an official statement anywhere describing what is going on. I would also challenge you to find a statement in the press. They have managed to keep this under wraps. I want to be clear. There are explanations for what has happened. Maybe the Treasury was worried that the Congress was going to tell them to send out \$1 trillion in cheques at short notice or something. I do not know. Or, maybe the Treasury were worried that maybe the Treasury (securities) market would continue to be disrupted and the debt manager wanted to make sure that they had enough funds so that they could engage in whatever activities they did.

My point is quite different. It is not that this is not sensible or that they (the Fed and Treasury) should not co-ordinate. My point is that they did not tell us. Co-ordination is easier, though, when mandates and governance are clear and when the roles are clear, and in those cases explanations will also be easier. That is just my local example of something that I think is poorly understood as a consequence of a lack of transparency but could be easily justified by a co-ordinated statement of some sort; and should be.

The Chair: Do you think the same criticism could be made of the Bank of England and the Treasury here?

Stephen G Cecchetti: I will plead marginal ignorance on what has happened. But, if I understand correctly, there was a period when the Bank of England was purchasing gilts at exactly the rate at which the UK Treasury was issuing them. I would say at a minimum that the optics are bad. Also, there should have been an explanation for what those numbers were and why they were doing it. Again, without knowing any of the details and not having been on the inside of anything or read all the news reports that I am sure you have all read, it looks like monetary finance, and that is not a good thing. But, again, co-ordination in a crisis is something you have to be able to do.

Q124 **The Chair:** There is another thing that keeps politicians awake at night. What is your assessment of the impact of a rise in interest rates on public finances and public services, given the position we are now in with QE?

Stephen G Cecchetti: I think it is extremely hard to say. I subscribe to the view that equilibrium rates are far lower today than they were three, four or even five years ago; much where they were 15 years ago. At a minimum, those rates would not have to rise by as much, so the sort of history I tend to look at—pre-2008 history—may be a poor guide for how high those would have to go. As long as those rates can stay below the nominal growth rate of the economy, I think you will be okay. It appears, at least casually at this point, that that would be the case. If we hopefully get back to normal in the not too distant future, longer-run nominal interest rates would not have to rise much above the growth rate of the economy. That means that these become sustainable.

The Chair: So you think that the risk is not severe.

Stephen G Cecchetti: It is not severe, no. Not yet.

The Chair: That concludes our session, unless any other colleague wants to come back on any particular point. We have two minutes left. Professor Cecchetti, you said that you had 40 years of very distinguished experience, and we are extremely grateful to you for giving evidence today. It has been very helpful, very open, very transparent and has given us much to think about as we frame our report. Thank you very much. It is greatly appreciated.

Stephen G Cecchetti: It has been my honour. Thank you very much.

The Chair: It is great to have you here. That concludes this session, and thank you to all colleagues who participated.