HOUSE OF LORDS

Economic Affairs Committee

Corrected oral evidence: Quantitative easing

Tuesday 18 May 2021

3 pm

Watch the meeting: https://parliamentlive.tv/event/index/f466d5a8-f0c0-41ea-89ca-f16df5eefe7d

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; Lord Stern of Brentford.

Evidence Session No. 19 Virtual Proceeding Questions 180 - 202

Witnesses

I: Andrew Bailey, Governor, Bank of England; Dr Ben Broadbent, Deputy Governor for Monetary Policy, Bank of England; Sir David Ramsden, Deputy Governor for Markets and Banking, Bank of England.

USE OF THE TRANSCRIPT

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

Examination of witnesses

Andrew Bailey, Ben Broadbent and Sir David Ramsden.

Q180 **The Chair:** Welcome to the Economic Affairs Committee. We have before us Andrew Bailey, Governor of the Bank of England, Dr Ben Broadbent, deputy governor for monetary policy, and Sir Dave Ramsden, deputy governor for markets and banking.

Governor, perhaps I could ask you the first question about the effectiveness of QE. The evidence we had included some research on the impact of QE by Professors Martin and Milas published in 2012. They found little evidence that subsequent QE programmes had much effect on economic growth, even if it did help to stabilise the financial system in 2008. In addition, there is no clear evidence that QE led to increased bank lending to companies. A staff blog from the Bank of England in July 2015 found that there was no evidence to suggest that QE boosted bank lending in the UK through a bank lending channel. Would you agree that QE has seen its effectiveness diminished over time?

Andrew Bailey: I would put it into a different perspective, if you do not mind. To step back for a moment, the basic mechanics of QE are that it is designed to lower longer-term borrowing costs for households and companies through the purchase of assets from the private sector financed by us as a central bank creating reserves. Those lower interest rates are designed to encourage spending on goods and services in the normal way.

I will come at this in two ways. In the literature and analysis of QE, three channels are set out as the ways in which it can work. It is true that there is a lot more debate and assessment of how QE works and its effectiveness than there is about the more conventional monetary policy tool of short-term interest rates. That is not surprising, in part because of the circumstances in which it is used, which we will no doubt come on to, and in part because, frankly, it is still a very recent innovation, and it was only after the financial crisis that it started to be used.

The first channel is a signalling channel about future intent in terms of desired market rates. Secondly, there is a portfolio balancing channel in terms of the effect of the purchases of assets by the central bank on the mix of assets in private ownership in the market. Thirdly, there is a market liquidity channel, which is particularly relevant in conditions of impaired market liquidity. Those are the channels. There is a lot of debate about the relative effectiveness of those channels.

The biggest point I would make is that the literature is not inconsistent with the points that you have been making. The literature and experience now are that there is a pretty strong degree of what we tend to call state contingency about the effects of QE. This does not mean that we consider QE to be effective only in some states of the world, but it does mean that we think it is more effective in some states of the world. The experience of the past 14 months or so bears that out.

QE is most effective in a situation where there is impaired market liquidity. Therefore, the market liquidity channel, the third of the three I set out earlier, in a sense comes into play most strongly. That was true post the financial crisis, and Lord King is a much better person to judge this than I am. It was certainly true in the circumstances of last March, which we will no doubt come to, in the so-called dash for cash. On our reading, it is not surprising, therefore, that the effects of QE vary over time, but I would not subscribe to the view that there is some sort of linear progression of QE and it becomes either more or less effective. There is a fairly strong degree of state contingency.

Q181 **The Chair:** Thank you for that. Would you agree that QE has created more inequality? For example, the evidence we have had from the Bank for International Settlements is that in 2016 wealth inequality had widened as a result of QE, and the ratings agency Standard & Poor's stated in its February 2016 report that QE exacerbated increasing wealth inequality in the UK. Would you agree with that?

Andrew Bailey: I say at the start that I would not agree. I will bring in Ben, because it is a subject that he has spent a lot of time looking at. Aggregate measures of inequality in this country have not moved a lot in recent times. It moved quite a lot in the 1980s. It has actually moved relatively little since then, but there is quite a bit going on under the lid, as it were. There is no question that QE operates through asset values. There is no question that—

The Chair: Before Ben comes in, I would like to pursue this general point.

Andrew Bailey: Do you want me to just make the point and finish? Feel free to come in if you wish.

The Chair: I am trying to get some quite short answers to specific questions. You have answered the point about inequality. You say that you do not think that QE has increased inequality. We have had a lot of evidence from people that it does. I was going to move on to the third aspect of QE on which we have had evidence, but it is up to you.

Andrew Bailey: I started by saying "in aggregate". There is quite a lot going on under the lid. There is no question that it operates through asset values. Of course, asset ownership is not evenly distributed. However, there is a second-round effect, which is to look at the effects of QE in terms of outcomes and ask where, in the counterfactual without QE, income and unemployment would be. Our view is that they would be worse, so it does feed through to those who do not own assets. If you do not mind, I was going to let Ben come in on this point.

Dr Ben Broadbent: Andrew has already pointed out that we have measures of inequality of income and wealth. Those for wealth do not go back as far; they go back to the mid-1990s. Those fell over the first few years and have been pretty flat since, including during the period when QE was conducted, so if there is an effect it is not manifest in those headline measures of wealth inequality; nor, by the way, are real asset prices much higher than they were. Real equity prices are still significantly lower than they were before the financial crisis, and house prices are pretty flat. It is possible that this effect exists, but if it does it is not sufficiently big to show up in those aggregate numbers.

As the Governor pointed out a moment ago, the primary thing that QE did was to support the economy. It is the less well off who suffer in recessions—it tends to be the less well paid and less well off who disproportionately lose jobs—so that too should be taken into account. That would tend, at the margin, to reduce inequality, at least of income.

The Chair: Dr Mohamed El-Erian in his evidence to the committee talked about the unintended consequences of QE and said, "I think that decoupling has occurred already in a major way … The major risk is that you decouple financial markets and create an unhealthy co-dependency … Not only do markets expect central banks to come in and repress any volatility, regardless of the source of that volatility, but they require it; they feel entitled to central bank support". Do you agree with that?

Andrew Bailey: I do not, but let me unpack that a little bit. Let us go back to the dash-for-cash incident last March. There was no question that we intervened at that point, but for two reasons that were consistent. One was because we were experiencing extreme market instability, not just in this country but in others. Secondly, it was at the beginning of the Covid lockdowns and the major economic impact right at the tail-end of the first quarter, but we could already see that coming upon us very much.

There was no question that we had to intervene at that point, because we were facing extreme market disorder. I would probably agree with some of Mohamed's sentiment. There is no question that there is a very large body of work going on internationally—I was on a call with the Financial Stability Board earlier today on the subject—to address some of the structural shortcomings that that revealed, because we cannot have a situation where the only thing that central banks, or the authorities, have in their locker is responding to this with major market interventions, if that is the only thing happening with market disorder.

May I give another example? Back in February we saw the beginnings of the turnaround in economic prospects and an increase in government bond yields. There were people who were saying, "This is a very worrying signal". In my view, it was not; it was a very sensible re-evaluation by markets of the economic outlook. There was no cause for central banks to intervene at all, and we did not. They certainly should not expect us to intervene every time there is a movement in markets of any note.

Q182 **Lord King of Lothbury:** Mr Governor, welcome to the committee.

Andrew Bailey: Thank you.

Lord King of Lothbury: I want to ask a few questions about the purpose of QE. You will remember that back in 2009 when QE was introduced the aim was to ensure that there was no serious fall in broad money supply that might create another depression. QE also had the beneficial effect at that time of increasing the liquid assets of the banking system. As you said earlier, circumstances change. QE under your tenure in March last year was expanded quite significantly. You have talked a little about that in the answer to the previous question, but could you say a little more about why QE was an appropriate response to the disruptions in financial markets at that time?

Andrew Bailey: We were facing very severe dislocation of core financial markets, by which I mean government bond markets. In that case, the gilt market and US Treasury market were in a similar situation. The real difference between 2009, as you have said, and today is that we have seen a very marked shift in the balance of financial intermediation from the banking sector to the non-banking sector in that time. I do not think we should be surprised by that. In many ways it is the natural consequences of the reforms put in place post the financial crisis, which were designed to correct clear fault lines in the banking system, but it has resulted in quite a major shift in the balance of financial intermediation to the non-bank sector so that, relatively speaking, the non-bank sector is now a lot bigger. The fault lines were in the non-banking sector in March, not the banking sector.

If there is at least one piece of good news in the events of the past 15 months, certainly in this country but elsewhere as well, it is that this has been the first major test of the post-financial crisis reforms of the banking system—and the system has stood up. This was not a response that was necessary for the banking system; it was necessary for the non-banking system and the liquidation of assets by elements of the non-banking system.

That gave us a challenge, because our conventional liquidity tools go through the banking system—it is what actually happens—or the central bank. It was very clear to us immediately that an intervention via the banking system was not going to solve the problem, because the liquidity would not reach where it was needed. That was the structural problem revealed that we had to tackle. We had to do something much more directly in the non-banking system that reached the core financial markets, in that case the gilt market.

Our view, and Ben may want to come in on this, is that in terms of the impact of QE it is the stock announcement that matters, not the flow, so it is the total stock of QE that we will announce rather than the weekly or monthly flow. I should say that not all central banks are in that position. In that case, with that degree of market dislocation, we had to do both, which was why we announced a big stock and a big flow, because we had in a sense to push liquidity very hard into the government bond market and get it to those parts of the non-banking system very quickly. That was the thinking behind this. I have to say that it worked in this instance.

Lord King of Lothbury: When liquidity was injected it seemed to be pretty successful in getting rid of the disruption to financial markets, and within a month to six weeks or so the disruption had gone away. But you did not withdraw any of the liquidity that you had previously injected to deal with that temporary disruption. Can you say a little about why you did not do that?

Andrew Bailey: In a sense, there were two drivers of why we did it. There was an immediate driver, which you have just raised and we have discussed, which was the financial market effect. Then there was the economic impact of Covid, the fact that we had a 20% fall in GDP in one quarter and that that raised very substantial financing needs, particularly for companies. We were very concerned to stabilise and keep stable during this unprecedented shock the cost of finance, particularly for the corporate sector which had to borrow quite substantially. People think it was done just through the government schemes, but it was not. There was extensive borrowing from the banking system. That was exactly as we hoped it would be, going back to the strengthening of the banking system, but we felt it was important in terms of monetary transmission that we kept stabilised the cost of finance to the economy, particularly into the corporate sector.

Ben, do you want to add something?

Dr Ben Broadbent: No, I do not think so. For the MPC, the primary objective was to make sure that we met our inflation target. The judgment was that, had this dysfunction continued for any great length of time, it would have been enormously contractionary for demand and ultimately inflation. Therefore, it required an intervention in size and, as the governor has just said, at some speed. Once that stock had been created it was still the judgment of the MPC that that was the appropriate stance thereafter.

Lord King raises an interesting point about how one knows what exactly the demand for liquidity is at any point in time when interest rates are already at or close to the lower bound, including market rates. Certainly, the primary objective was to hit the inflation target. I do not think there is any inconsistency, therefore, between addressing the liquidity needs and meeting that target, because if you had not done one you would not meet the other.

Q183 **Lord King of Lothbury:** Can I take you to further through 2020 when, in the words of the MPC, the emphasis on the objective or purpose of QE shifted towards supporting the economy? You talked just now about the prospect of a 20% fall in GDP, which is dramatic, but the potential supply of the economy also fell extremely sharply, and, in the view of the OBR, basically supply fell in line with demand. It recovered in the summer and autumn of last year and fell again with the second wave. There does not seem to be a very large gap between the path of demand and supply that would justify significant QE to support demand at a point when supply was falling in line with it. How did you think about that during 2020?

Andrew Bailey: We spent a lot of time on this question, and still do. You are right that this was in no way a normal recession, in the sense that in a normal recession—I caricature it somewhat, but not much—the fall in demand relative to the fall in supply is substantial, whereas here we tend to say in the MPC that we have two big moving parts, both supply and demand, which makes it much more complicated to assess the output gap.

Our view—I will be very cautious in what I say here—is that the evidence particularly from the inflation outturn suggests that there is an output gap, but it has moved over time and is much harder to assess than normal. By the way, if we run through GDP in the last year, we find it easier to express this in levels and growth rates. We had a 20% fall in the second quarter. About half of that was recovered over the summer and early autumn, so when we arrived at October/November time we were still 10% down.

The good news is that it was 10% less than we were down at the end of the second quarter, but we were still down by quite a long way at that point. To be clear, that was the point at which we started to see the return of Covid and the restrictions. As you rightly say, that complicates the assessment of the output gap. Our assessment is that there is an output gap, but it is nowhere near the sort of gap you would expect given the fall in GDP in a more normal recessionary situation. I agree with you on that point.

Lord King of Lothbury: The OBR put it at only 1%, which is very small in relation to the actual movement of total demand.

Andrew Bailey: It is uncertain. We have discussed many times in the past that estimating output gaps is subject to false accuracy. You are right that, whatever the output gap is, it is small relative to the fall in demand, but our view is that there is one.

Sir Dave Ramsden: The other thing going on last year was that we were focused consistently on bridging across to when we thought, in an incredibly uncertain environment, that the pandemic might be easing its effects on the economy. When we were completing those stocks of target asset purchases that you have drawn attention to, as market conditions allowed we were also slowing the pace quite markedly. It went at historically unprecedented rates back in March and into the spring. By June, we announced we were halving the pace of purchases, and for the subsequent programmes we set out the target stock, which is still the key driver in what we are trying to achieve in the economy, but we were also conscious of slowing the pace as appropriate.

You find that, bringing it up to where we are now, we are purchasing about £3.5 billion of assets a week, which is much more in line with the kind of rates of purchase that you would have been familiar with in your time as governor. That is on the current programme to bridge to the end of this year when we think the level of GDP will be back at the pre-Covid level of output. Therefore, we will have bridged through two years of below-trend output. Notwithstanding your comments about the uncertainty around the output gap, that was how we were changing the operationalisation and pace of the purchase programme. I hope it was useful to add that.

Q184 **Lord Haskel:** Before I start, for the record my son Jonathan serves on the Bank's Monetary Policy Committee.

Andrew Bailey: It is an absolute pleasure to have him as a colleague.

Lord Haskel: Thank you. He gets it from his mother.

Andrew Bailey: You are too modest.

Lord Haskel: My question, Governor, is about communication. Do you think that it is part of the Bank's remit to communicate its policy actions to the public? Will policy be less effective if people do not understand what you are doing? If so, how effectively do you think the Bank has communicated its policy during the pandemic?

Andrew Bailey: It is certainly a very key objective to communicate to the public our policy actions and the consequences of them. Our goal and objective is price stability. Establishing and maintaining an understanding of price stability, which will then feed through into the public's expectations, particularly its expectations of inflation, is very important. Lord King will remember when the MPC was first set up. He was the mastermind of it. I think the title was "Building a Consensus for Low Inflation"; you will correct me if I am wrong on that. We put a lot of emphasis on establishing the importance of price stability going forward, and nothing has changed in that respect. It is a critical thing, because you can never take it for granted.

Let me say two things about the past year. One is that in such a volatile economic environment communication is a challenge. It was a most extreme challenge for us, unsurprisingly, during the second quarter of last year when activity in the economy was falling by 20%. It may have happened in 1709, but it is unprecedented. Probably a good indicator of the challenge that we have is the fact that in the monetary policy report that we published last May—almost a year ago now—for the first time ever in the history of what used to be the inflation report, which again Lord King introduced, we did not publish a forecast of the economy. We used a simulation, because we were so uncertain about the economy at that point that we felt we could not do it with confidence, and it would run the risk that we would communicate something with a degree of confidence and certainty in it that frankly we did not have.

That was a very challenging thing to do. We were very clear about the risks in using a simulation. The difference between a simulation and forecast can be explained, but it is not straightforward. We were very concerned about that, but it was a reflection.

Going back to what we have already said this afternoon, there is no question that QE is a complicated policy instrument to explain. There is no question that moving short-term official interest rates is an easier policy tool to explain broadly than QE. QE is a challenge to us, and it is one we have to take on and maintain, but I am under no illusions that in explaining monetary policy in a world where QE is a tool it is harder to communicate.

Lord Haskel: To probe that a little further, in November 2020 you chose to buy an additional £150 billion of government bonds.

Andrew Bailey: Yes.

Lord Haskel: Did you feel it was important to communicate why you chose that amount rather than, for instance, £200 billion or £100 billion?

Andrew Bailey: First, let me go back to something Ben said a few minutes ago. The anchor for this is the inflation target and our analysis of it, and the prospects of meeting it. In our meetings, the quarterly monetary policy report forecast is used as part of that assessment. Our judgments on whether it is £150 billion or £200 billion are made to the best of our ability essentially by putting those numbers through our assessment processes and deciding which one of them, in a sense, given all the other analyses we do, is best to take, over the course of the horizon, which typically is up to three years, to have inflation at its target.

The second point about QE is that we must have an eye on the question of how much so-called headroom we have in our ability to purchase assets, particularly the ability to purchase gilts, because the predominant component of the stock of QE is gilts.

I was very conscious, going back to last March, that both Mark Carney in his last weeks and I, when I was coming into the role of governor, had been asked by the Treasury Select Committee about the headroom we had. This was pre-Covid, or pre Covid becoming a big issue. We had both given a reasonably low number. We gave the same number, not by coincidence; it was about £150 billion. Of course, that changed dramatically.

But there is a symbiotic relationship here, because it is related to the stock of gilts in issue. We have a policy regime for how much of the market we can buy and a policy regime that we split into three maturity buckets: short, medium and long term gilts. That creates the headroom.

In answer to the question why it was £150 billion, it was driven primarily by the inflation analysis and target, but sitting behind it was also an assessment of the headroom we had to undertake purchases, so we could not have gone at that point in time hugely above that number, frankly.

Lord Haskel: To move on to communication and the Bank's credibility, in June 2020 you said that if the Bank had not intervened, "I think we would have [had] a situation where, in the worst element, the Government would have struggled to fund itself in the short run".

Andrew Bailey: Yes.

Lord Haskel: Are you not concerned that the way this policy was communicated would damage the Bank's credibility by giving the perception that it has practised monetary financing during the pandemic?

Andrew Bailey: Not at all. I know there are people who say this. I am afraid I reject it out of hand. What we did, in that week in March, was designed to stabilise financing conditions and financial markets across the whole economy. Part of those financial markets is the government bond market. The government bond market plays a much bigger role than just financing the Government; it is also an anchor in financial markets because it is a risk-free asset, so an awful lot of collateral and security in financial markets is government bonds.

So a meltdown in that market, which was frankly what we had on our hands, would have had widespread impact. It does not mean that the Government were in any sense insolvent; let us be very clear about that. But if we had allowed that to go on, and to get worse, companies would not have been able to finance themselves, people would not have been able to borrow in the mortgage market, and the Government would have found it very difficult to conduct auctions of gilts. That is the reality of it. That is not compromising the central bank's independence one bit. It is doing what any central bank needs to do, which is to carry out its duty both in respect of financial stability and monetary stability and stabilise the markets, and that was what we did.

Q185 **Viscount Chandos:** Governor, a number of our witnesses have said that of course there should be co-ordination between the Bank and the Treasury. Others, following Lord Haskel's last question, have worried that the co-ordination is one-sided or even coercive. Can you say how much and what type of co-ordination took place between the Bank of England and the Treasury during the pandemic, particularly in the early months?

Andrew Bailey: Yes, happily. I start by saying that we do not use the word "co-ordination" really for the reason that you and Lord Haskel have said, which is that it implies something more than is the case. It implies active management of policies jointly, and that does not happen. We tend to use the words "consistent" and "complementary"—apologies for using two words to replace one—for the reason that we are independent, but fiscal policy and monetary policy are both performing the same function at this point. They are both countercyclical policies that aim to stabilise the economy, so in that sense they are operating consistently.

I can tell you that the Chancellor and I were talking daily at the height of this. I do not think anyone should be surprised at that. I would contend that if we were not talking regularly, people should be pretty worried that there is no proper contact. If you asked me what we talked about, I would say two things. At that point, we were basically sharing our assessment of what we were hearing about the economy. It is important to bear in mind that we were in a situation of unprecedented uncertainty. A 20% fall in GDP in one quarter is unprecedented, huge and subject to enormous amounts of uncertainty as to what on earth is going on around us. That was the first thing.

The second thing that dominated our conversations was Covid. Both the Bank and the Treasury were coming to terms with understanding an area about which neither of us professed to be expert, so we were both trying to work out what we were hearing from epidemiologists and to turn it into something that we could interpret in relation to our objectives. We were both trying to work out what the R number meant and what it meant for the economy. That was taking up a lot of time. In my view, those are things that the Governor of the Bank of England, the Treasury and the Chancellor should be talking about.

Viscount Chandos: In giving evidence to the committee, Lord Macpherson said—I paraphrase it a little—that the prospect of the asset purchase facility making losses was finally coming into view and that it would be an interesting test of the relationship between the Bank and the Treasury. I think that historically the Treasury is in credit by about £110 billion, so over the whole period there is money in the bank. But in the event of moving into losses, particularly if they become realised mark-to-market losses, that or more could be given back in, putatively, a single year. We are all a bit in the dark, because the deed of indemnity is not public. How do you think the relationship between the Bank and the Treasury will weather that sort of moment?

Andrew Bailey: You are right. The latest number I have is £112.5 billion. That has been paid over a period of time. Lord King will remember it well. It does not go quite back to the origins of QE. There was an agreement one or two years in over the payment over of funds.[1]

Going back to Lord Haskel's question, I would observe in relation to communications that £112 billion number is one of the less well-known numbers in this whole landscape. It is important, as you say, because QE is not meant to be a profit centre; it is not a form of fiscal policy to raise money for the Government. The flow has been one way in the period up until now because, on the whole, over that period interest rates have fallen; the yield curve has moved down. As you and Lord Macpherson have rightly said, we have to look forward to a period where at some point the yield curve will change. We have seen some change in the past couple of months.

That is a fact of life. You are right. An independent central bank is meant to operate policies to hit the inflation target, and the consequences of that for the flows of money through the so-called APF will follow.

I will bring in Ben at this point. You cited £112.5 billion being wiped out in one year. Ben will come in with some arithmetic. I do not think that is very likely.

The Chair: We are quite well behind on time. It is an important point, but perhaps you could make it briefly.

[1] The details were set out in an exchange of letters between the Chancellor of the Exchequer and the Governor of the Bank of England. See www.hm-treasury.gov.uk/d/chx_letter_091112.pdf and www.bankofengland.co.uk/monetarypolicy/Documents/pdf/govletter121109.pdf

Dr Ben Broadbent: The simple point is that that £112.5 billion, as Andrew says, reflects the fact that Bank Rate fell well below what markets were expecting at the time when we bought the various batches of gilts. It is not quite necessary for Bank Rate to go back to where it was before the crisis, but it would need to go a long way before you fully reversed that £112.5 billion. I think it is highly unlikely. Interest rates would have to go up by several hundred basis points to have it reversed within a single year. I imagine that it would be well over 5%, 6% or 7%, so I find that very unlikely. If you took the path of interest rates that bond markets expect over the next 10 or 20 years, you would not fully reverse it even over that time. We will see. As Andrew says, in terms of short rates, the Bank will do what is necessary to meet the inflation target. We cannot predict in advance exactly what that is, but it is highly unlikely that you would have to pay it back in anything close to a year, even eventually.

The Chair: Viscount Chandos, do you have a further question?

Viscount Chandos: Nothing further, no, thank you.

The Chair: Ben, could you help us? If there was a 1% increase in interest rates, what would the effect be on the Treasury?

Dr Ben Broadbent: I will make a point and a half here, if I may. I think the right thing to do is to understand it in comparison with what else might have happened. If you get a percentage point rise in interest rates across the curve, short and long rates, given government debt of close to £2 trillion, interest payments would eventually go up by £20 billion. That number has nothing to do with QE. That would always be the eventual increase in debt interest payments if you have an interest rate increase of one percentage point all across the curve.

What QE does at the margin, all else being equal, is accelerate the effect of that. If I put up short rates and all these interest rates, that £20 billion would come through slightly more quickly than if QE had not been done. However, all else is not equal. Remember that in the background the maturity of the gilt stock has gone up slightly since the financial crisis. Indeed, even taking account of QE, the overall maturity of the liabilities of the public sector, looking at the consolidated balance sheet of the Bank and the Government together, is still not far off where it was in 2010 and is materially higher than that in other countries.

I do not think it is the right experiment to say that if interest rates go up by a percentage point. You have to ask why they have had to go up. You have to ask what would have happened anyway, even in the absence of QE. The fact is that the uniform increase in interest rates—QE does not affect the impact of that increase in interest rates on the eventual debt interest payments of the Government. I can guarantee that this MPC and future MPCs will not be thinking about that one whit anyway; they will be thinking about hitting the inflation target.

Q186 **Lord Fox:** These questions are designed to investigate the effects of the

Bank’s expanded role on its political exposure. We heard evidence from a number of people that this was the case. Perhaps the most notable came from Otmar Issing, former chief economist of the ECB. If you will excuse me, I will quote him quite a lot. He said, “They [the central banks] are in a trap … constructed partly by themselves [because they] gave into all the pressure from political [institutions] to be responsible for everything from green [policies] to redistribution”. He goes on to say that that will be a tremendous challenge for banks to get out of.

We heard evidence from others. The governor’s stated aim for communications also pushes the Bank into the communications arena, as does the fact that we are having this discussion. Whether that is the reality, there is certainly a very authoritative perception that the Bank is now in a different political space.

Could the governor tell us his assessment of the reality of that and his assessment of how the perception that the Bank is in a more political space affects the long-term reputation of the Bank?

Andrew Bailey: I do not think of the Bank or myself as being in a political space in any conventional sense. I am not a politician; I have no affiliation whatsoever, and I do not regard it in any sense as part of my job to be in that world.

To go back in time a little bit, when the Bank was given independence for monetary policy back in 1997 that gave it responsibilities. We have a very clear statutory framework in this country, which is an enormous strength, in my view, but it meant that the Bank had to adopt a much more forward and open position in explaining itself. By the way, what is happening this afternoon is part of that. We have to be publicly accountable to Parliament, and we take it very seriously. If we were in any sense to resile from that it would damage the regime and put the Bank in a position where it was not credible as an independent authority, so we have to take on the communications challenge. There is no question about that.

The Monetary Policy Committee is 25 years old next year. Lord King will know better than I do that the first 10 years were, as he described it, a nice decade when things were pretty stable. I can tell you that they have been anything but in the period post then. We have had a major financial crisis, a pandemic and Brexit in that period, so the shocks have been in a rather technical sense quite marked—

Lord Fox: All of those are pushing you into the political arena.

Andrew Bailey: We have to deal with the consequences of them, given our independent responsibilities. We cannot avoid it. We cannot say, “Covid is nothing to do with us”. We have to deal with the consequences of that for our responsibilities and explain how we have dispensed the responsibility.

You raised the question of climate change.

Lord Fox: I think there is a more detailed question at the end about climate change.

Andrew Bailey: Let us leave that until later. I was going to use it as an illustration, but I am happy to come back to it. We have to explain ourselves. We have to explain how we handle these shocks, some of which are of a political making—for example, you might say Brexit; some are obviously not. Covid is a natural disaster, we think. We have to deal with them and explain ourselves, and that is right. I do not regard that as being in any party-political sense. What we do have to do is be accountable to Parliament as part of that. In that sense we have to engage with that process.

Lord Fox: Some of the evidence we heard, for example, from the University of York, was about ways in which you might mitigate the perception of politicisation. In its case it was about having an exchange of letters with the Chancellor that pushed politics in the Chancellor's direction. Are you not persuaded that in order to deal with the perception part of it some mechanism to distance yourself from politics and political issues might be helpful?

Andrew Bailey: I do not regard myself as being in any sense part of the political process. I regard myself as having to deal with the consequences of it from time to time—

Lord Fox: But does it matter if other people think you are involved in the political process? Does that not bother you?

Andrew Bailey: Yes, it does, in the sense that I have to go to greater lengths to explain what an independent central bank is, what it means and what it does, so I do respond to that. Obviously, if I see any evidence or people say to me that the Bank has been "politicised", that will cause me to want to redouble my efforts to explain what the Bank of England does as an independent central bank.

Q187 **Lord Bridges of Headley:** Governor, I want to return to the point about independence and then come on to accountability. Given all you have said, does it bother you that a survey that the *FT* conducted earlier in the year of the 18 biggest players in the market for UK government bonds found that most think that the Government and the Bank are working together, and that, in the words of a macro-strategist at Goldman Sachs, "fiscal monetary co-ordination has been a noteworthy feature of the UK's Covid policy response"? Does this somewhat undermine the perception of independence? If so, what will you do about that?

Andrew Bailey: It does. I remember it very well; I read it myself. Let me go back to the point I made. We have been following policies that I view as consistent and complementary. I think the people of this country have a right to expect, in the face of a shock as big as Covid, bearing in mind that it appears to be one of the biggest economic shocks in the past 300 years, that the authorities will do everything they can within their remits to deal with the consequences of this. That is what we have been doing but within our remits.

People can say that that means that there is a higher level of co-ordination. They can go further, which I will reject out of hand, and say that in some sense we have abandoned the remit and are just doing things together to suit some other purpose. There is no truth in that whatever. We have been pursuing our remits in the face of a huge shock. I do not for a moment want to resile from that. I would like the people who are responding to those sorts of surveys to understand the situation in which we find ourselves and the remit we have, and the fact that, yes, we have put all our tools to work, because, frankly, that is our duty.

Q188 **Lord Bridges of Headley:** In terms of accountability, processes and governance, given the large amount of QE that has been undertaken certainly in the past year, what changes have been made to reflect that within the Bank of England? I have a second follow-up question on the override powers, but let us take that one to start.

Andrew Bailey: We have not really changed the operating framework in the past year, except for the obvious point that we have had to do everything remotely, virtually. The basic framework of operations has remained pretty much unchanged and has stood up to the test in that sense. There has not been a fundamental change in accountability in that sense.

Lord Bridges of Headley: As for the override powers, in what type of situation do you foresee the override powers coming into effect? I note that in the legislation itself the phrase used is "extreme economic circumstances in which the operational independence of the Bank might be curtailed temporarily". What would that actually comprise in your mind?

Andrew Bailey: I will say two things. First, there has been no discussion at any point in time about using the override power in the Covid crisis. I would not for a moment dream of wanting to do so. I would also say that the legislation provides that if the override power is used it suspends price stability. In my view, that would be a catastrophic mistake. We would be throwing away nearly a quarter of a century's progress in monetary stability.

You asked me a question—forgive me, we are now in the realms of imagination—about the circumstances in which it would be used. I have never been party to a discussion about this. You can come up with all sorts of scenarios—for example, meteors or asteroids hitting the country and destroying the Bank of England. There may be scenarios, but given the fact that it suspends price stability, particularly in the circumstances we have been through in the past year, in my view that would be a catastrophic mistake. I am very glad that nobody has ever suggested it, certainly not in my hearing anyway.

The Chair: Lord Fox, you wanted to come back with a further question.

Q189 **Lord Fox:** It concerns the deed of indemnity, which is a kind of mystery document the contents of which we can speculate on. That speculation somehow feeds some of the perceptions that you and I were discussing just now. This is an opportunity for you to confirm, without revealing the contents of the particular document, that it does not cause you to have to ask for permissions that you did not have to ask for. In other words, it has not changed your behaviour in terms of your relationship with the Chancellor in any way.

Andrew Bailey: No. I have read it.

Lord Fox: I am glad you have.

Andrew Bailey: It is a legal document. It is not a gripping read, but then you would not want it to be. There is no mystery to it. It basically sets out the terms of operations of the asset purchase facility and how the indemnity that the Treasury gives us works. On the question of publication, it is a Treasury document, so it is not something that the Bank of England could agree on its own to publish.

Lord Fox: But it does not cause you to have to ask for permissions.

Andrew Bailey: No, not at all. It sets out a process, but there is no mystery to it. There is nothing underhand about it at all.

The Chair: Can we take it from your answer that you would not object to it being published?

Andrew Bailey: I think there are slightly wider considerations about the precedent it would set. Lord King will remember that sometimes we had to do indemnities for other things in financial crises where it was imperative that it was not disclosed for a period of time because of the sensitivity of it. I think there would be a bit of concern about the precedent it sets. I have to be honest with you: I have read it. I could not see anything in it when I read it that I think would excite people if it were published, but it is not my decision—it is the Treasury's.

The Chair: You are telling us that it is completely benign, but the Treasury thinks it should not be published.

Andrew Bailey: If you have an appetite for legal documents—

The Chair: This committee has quite a lot of that, I have to tell you.

Q190 **Baroness Kramer:** Governor, a moment ago you listed a whole series of shocks that both the economy and the financial markets have taken, both known unknowns and unknown unknowns.

Looking forward, if economic recovery does not go as smoothly as we would all wish and financial markets remain perhaps weak, are you concerned that the Bank could be stuck with a QE infinity if it is just unable to exit the zero lower bound ahead of any future downturn or new shock or crisis? If that were to happen, is QE a busted flush, and are there any other tools that could serve the same purpose?

Andrew Bailey: That question has quite a few parts. I will ask Ben or Dave to come in at some point. It is true to say that in the QE undertaken after the financial crisis, to which Lord King referred, there was not a period of time when the Bank was able to exit from that QE because other things came along. So whereas the Federal Reserve did do some exit between the financial crisis and Covid, the Bank did not find itself able to do that.

I would not wish to suggest that we have hit the limits of QE. We keep that under careful review, but there are no natural limits. My strong preference is conditioned to a considerable degree by the fact that we are in a world of what we term very low equilibrium interest rates. I think most economists will tell you that the expectation is that that broad profile will continue for some period of time, because the reasons for it are more structural than cyclical. By the way, that is not giving you any view on what the MPC will do at any point in time. That is a much longer-term comment.

I will come back to interest rates in a moment, but given that QE is, if you like, the other tool, I hope we can get to a point where we can operate QE, if we need to, if we get another shock—we have had a financial crisis and a health crisis—and we will have been able to adjust the Bank of England balance sheet countercyclically and can unwind QE to some degree. We are not in a position at all to promise or predict that at the moment. We are at the moment carrying out a review of how the Bank would approach that question. I think it is very sensible to do that, given the huge change we have had to take on board with Covid. I would like the central bank balance sheet to be countercyclical in that sense.

I should say that it will not return in any state of the world to the level it was before the financial crisis, because demand for liquidity in central bank reserves has risen, in good part because of the experience of the shortfall in liquidity in the system in the financial crisis, but clearly it would be lower than it is today.

We have spent a lot of time in the past year on the question of what the toolbox of monetary policy tools is. We have had to spend more time on this than traditionally we would have to when using short-term interest rates in a more normal environment. As is well known, we have been evaluating the possibility of using negative interest rates. We have got nowhere near any discussion of whether we should use them, but we have taken the view that in the toolbox, which is broad and not narrow, it is a sensible thing to have because other central banks have used them. I should emphasise that there is a range of views on negative interest rates, but it is useful to have other possible tools.

Ben, do you want to add anything?

Dr Ben Broadbent: I do not think so, Andrew, you have covered everything.

Baroness Kramer: Perhaps I can try to get a little clarification. The position of the MPC has been that you would not look at quantitative tightening until the bank rate had risen, one assumes, to 1.5%. I think you have made speeches to suggest that you would want to act earlier than that. I am just trying to understand whether you are reinforcing that particular change or difference.

Andrew Bailey: That is what we are reviewing at the moment. The reason is that that policy was adopted by the MPC in 2018. I am afraid that the world looks very different today. Our balance sheet looks very different today. Therefore, there is a really strong case to re-evaluate that decision in the light of what has happened since, and that is what we will do.

My personal view is that whatever we do needs to be done on a predictable basis, which is announced in advance. I would want it to be predictable and consistent, obviously with an override to deal with any shocks that came along afterwards. If we go to a number of the questions that have been asked about the politics of this and whether this will be the most challenging moment, one of the natural things to do in dealing with the political economy of that situation is to say that the Bank of England will announce what it thinks is a sensible policy on that front and operate it automatically.

Baroness Kramer: Do I read from that that we will get a road map to some degree of these scenarios?

Andrew Bailey: Only at a point when we think that is the appropriate thing to do, subject to the review we are doing.

Q191 **Lord Skidelsky:** The governor talked about not having been in a position to pursue countercyclical policy, but you have not been in a position to do that for 11 years. That is the time we have spent doing the QE experiment. Does that not mean that QE is a much less potent implement than you are arguing for, either in terms of inflation control or recovery control, because if it were more potent you would not have such a problem in unwinding? It is because QE has not been countercyclically effective that you are facing the problem in unwinding, despite the fact that the situation has changed quite considerably over that 11 years.

Andrew Bailey: I was not saying that we have a problem in unwinding but that we are rightly reconsidering how we would approach the question, given what has happened. I will get Ben to come in. The fact that we have not unwound goes back to the point I made that the shocks we have seen over the past decade or so have been so much larger in the UK, putting the Bank in a position where it was not able to start that unwinding programme. That is not a fault of QE; that is a comment on the shocks that we have seen.

Ben, would you like to comment?

Dr Ben Broadbent: To my mind, standing back as an economist, I think it is extraordinary, given those shocks, that inflation has been as stable as it has been. That does not mean that you infer that QE does not do anything. If anything, you infer the opposite. If you look around the world, certainly at what happened in Japan even before the financial crisis, but more recently in continental Europe and the United States, we have avoided the problem of having too low inflation. That was a real possibility after the financial crisis. If you look at market prices, their judgment was that there was a real possibility of falling into low inflation traps in other jurisdictions.

We avoided that, thankfully. We have avoided it thus far, and we have avoided it partly because the independent MPC was able to take the decisions, including QE, in order to meet its inflation objectives. I do not for a moment think that any of that tells you that QE was ineffective. If anything, I think the opposite is true. As I say, if you look at the enormous range of shocks that have hit the economy over the last decade or so, it is remarkable that inflation has been as stable as it has been.

Lord Skidelsky: But the governor has admitted that QE has failed as a countercyclical policy.

Andrew Bailey: No, I—

Lord Skidelsky: That is what you said.

Andrew Bailey: No, I have not.

Lord Skidelsky: You said that you were not able to pursue countercyclical operations in the period 2009-13.

Andrew Bailey: That is because of the shocks that we have experienced.

Lord Skidelsky: There will always be shocks.

Andrew Bailey: These have been big ones.

Lord Skidelsky: You cannot have a policy that is effective only in a given state contingent situation. State contingency is changing the whole time. You are left with one in particular, which was fiscal policy.

Andrew Bailey: I am sorry to state the obvious, but we have had the largest financial crisis in modern history and we have had the largest health crisis in modern history in that period. This has not been a normal period. I am sorry, but that was not the point I was making at all.

The Chair: Okay. Can we move on to Lord Monks?

Q192 **Lord Monks:** Governor, this is a question about inflation, which we have just been talking about. How concerned are you that the latest round of QE could make inflationary pressure rather worse? One is reading quite a lot in the newspapers at the moment, for example, about the construction materials sector and the food sector, not just in Northern Ireland, experiencing shortages and consequential rises in prices. How concerned are you that QE could have an effect on this situation?

Andrew Bailey: I go back to something that Ben said earlier. The round of QE that we are currently operating, which we announced in November, was a key response from us in terms of the worsening Covid crisis at that point. As Ben said, its effect, we hope, is to restore the level of output in the economy back to where it was at the end of 2019. We do not expect more than that this year at the moment. That round of QE will be over by that stage.

Ben and Dave will want to come in, I am sure, at this point. Let us look forward. Some 12 days ago we produced a monetary policy report. Our forecast at the moment is that we do expect inflation to pick up in the next month or so. It has been under 1% in my entire time as governor, and I have had to take every opportunity I have had to write a letter to the Chancellor to explain why inflation is more than 1% below target. We do expect that to change, because there is quite a strong shift in energy prices relative to where we were a year ago. So there are what we tend to call base effects coming through. Those very low energy prices will drop out of the calculation.

The judgment which the MPC has had to make, and will have to go on making, is: do we think that those base effects, which left on their own will be temporary, will not persist and that inflation will come back down at some point? Do we think it is most likely that inflation, which we put into the report 10 days ago, could go above target a bit temporarily later this year, due these base effects? Do we think that it will come back towards target or not?

Our judgment at the moment is that it will, because we see the bounce-back in the economy but we do not see that sense of momentum continuing forward at that pace at all. Fiscal policy, for instance, is very supportive this year, but it starts to tail off next year under the announcement in the Budget. Or do we think it will persist, in which case, of course, it will present a different challenge to us?

We are watching it very carefully, I can tell you. At the moment, we do not see that evidence, but we will watch it, as we must do, very carefully. I apologise for the noise in the background. I think the gods are judging what we have been saying.

Ben or Dave, do you want to come in?

Sir David Ramsden: Could I provide some background numbers to what Andrew said? We think that these base effects were worth 50 basis points or 0.5% of inflation in dragging down the inflation rate at the end of 2020, and they will make a 75 basis point positive contribution in 2021 Q4. That is just the movement in energy prices.

Going back to what we discussed with Lord King earlier, we are also assessing the balance between demand and supply, and the extent to which there is any excess demand pressure. As Andrew has just said, we do not see that being sustained, because we think that momentum will slow in the economy through this year for a number of factors.

Finally, we are in a position now where, over the last year, Andrew has just written his fourth open letter to the Chancellor because inflation is more than 1% away from target. We are still seeing inflation coming back to target and then a temporary period where it may rise above, and we see the risks around that balance. But we keep a very close eye on inflation expectations measures, given that our remit is price stability and a 2% inflation target. So we are very vigilant to any sense that inflation expectations would de-anchor.

Ben talked a minute ago about how in other jurisdictions—the US and the euro area—inflation expectations have been very depressed, and particularly in the US they have moved up quite markedly, as we drew attention to in the monetary policy report. In the UK we have seen a little bit of a pick-up in inflation expectations. We highlighted that in the monetary policy report. We are keeping an eye on that, but we think that inflation expectations across both those financial market measures and survey measures still remain well anchored, which reflects the credibility of the UK monetary framework.

The Chair: Ben Broadbent, did you want to say anything about this?

Dr Ben Broadbent: It is an interesting question. One of the extraordinary features of the pandemic has been not just the enormous moves in aggregate spending—and, indeed, aggregate supply, as Lord King pointed out—but these huge movements beneath the surface away from spending on services that were restricted towards spending on goods. Housing markets have been strong, at least outside cities, in every country in the world.

What we expect to see, therefore, is not just a rise in inflation as the economy recovers and as the energy price effects take effect, but, within certain bits of the economy, pinch points where demand might run ahead of supply in particular areas. You are right to highlight, for example, prices of traded goods and certain commodities; computer chips have been another. Therefore, it will, I suspect, be a bit bumpy through this year as these bottlenecks pinch. We have seen some of them already in the United States.

As Andrew and Dave outlined, our judgment then has to be focused on the medium term. What, if anything, does that mean for inflation one, two, three years ahead—inflationary pressure at that horizon? That is what we will be looking to when we set policy as the MPC.

Q193 **Lord Monks:** As a quick follow-up, your departing chief economist has taken a rather pessimistic view of the economic outlook and the outlook for inflation. Are you concerned at all that the Bank's credibility would be eroded if and when inflation does pick up beyond the forecast that you have for Q4, which is 2.5% at the moment? Are you seriously worried about that? I know it is an inexact science; you said that earlier. Is this something that keeps you awake at night?

Andrew Bailey: I think Andy Haldane takes a very optimistic view. His view of growth is more optimistic, because he thinks that there will be continuing momentum, and that is what leads to his view on inflation and monetary policy.

I speak for myself now. I think we need to see the evidence unfold. In my view, we have not yet seen evidence to support that view. I do virtual visits around the country at the moment, and, yes, we do hear those stories about input prices, but we are not yet seeing strong evidence of it passing through into consumer prices. However, I can assure you that we will be watching this extremely carefully and we will take action when we think it is appropriate to do so. There is no question about that.

The Chair: Governor, anecdotally, I was talking to a contractor only yesterday who told me that the price of wood had gone up by 90%, which is a combination of shortage of supply as well as everything else.

Andrew Bailey: Yes.

The Chair: I said it will come down when the supply comes back. He said, "Prices never come down", but that may be a cynic's view of these matters.

I know Baroness Kingsmill wanted to come in on this, but she is not there. Lord King, I know you have a question on this.

Q194 **Lord King of Lothbury:** The three of you have given a very balanced set of answers to the questions about the inflation outlook. All that sounds extremely sensible, but it does not square well with the view that some central banks have given anyway that they want to keep policy easy for a long time. The impression you have given is that you are ready to move policy in either direction according to how the data turn out, and that you are perfectly willing to raise rates if necessary if you find evidence to suggest that any rise in inflation will persist beyond a very short-term period. Could you confirm that that is your position and that you are not saying to the market that you want to keep rates low for a long while in order to get out of the position that we are in?

Andrew Bailey: As you know, we have a symmetric inflation target, and that is appropriate. One of the things that you are rightly alluding to is that there is a difference, obviously, as you know, in some of the operating frameworks of the central banks. There is also a difference in the inflation history over the last decade. If you look at the UK experience since the financial crisis, on average inflation has not been very far away from the target. If you look at the US or the euro area, you do not see the same conclusion or outcome. Inflation has been further below target.

Ben will want to come in on this, I am sure. One reason for the different experience in this country is that we are an open economy and the exchange rate channel plays a bigger part in inflation outturns in this country. I think the analysis would suggest that that is part of the answer to that question. The reason I am making this point is that we do not have that same experience in this country. Even if there was any temptation to go in that direction, it really would not be appropriate given the history of this country anyway.

Ben, did you want to come in?

Dr Ben Broadbent: That is absolutely right. I mentioned in answering an earlier question that we have not, thankfully, seemed to have had, thus far at least, the same difficulties with both realised inflation and expectations of future inflation falling persistently below target. As you know, that can create, in principle, the risk of a trap in which it makes it very difficult to release policy sufficiently to raise inflation back up. As Andrew said, that may be connected with the openness of the economy.

The same is true, for example, of Canada. I suspect that may be why the US Federal Reserve, the FOMC, has decided in essence to aim for a period of inflation slightly above its longer-term target. That may make a difference to its policy stance. We have had to ease policy, including over the last year, to meet the inflation target over the medium term. That will continue to be the focus, and, as Andrew says, it is a symmetric target. That does not mean that you immediately pounce on it as soon as it goes above 2%, any more than you would immediately ease policy for every reading below 2%. What matters is the pressure over the medium term, but we have a slightly different framework and we have not changed it in the way the FOMC has.

Q195 **Lord Bridges of Headley:** Governor, the *FT* reported that at the Resolution Foundation you said, "We will need more evidence than we usually do that we are seeing a sustained uprise in inflation". Can I pick you up on that point about "more than we usually do"? In practical terms, if you are able to, can you point us towards that extra evidence that you would be looking for?

Andrew Bailey: I said that, because we have had unprecedented levels of uncertainty. The level of uncertainty in the economic outlook over the last year has been at unprecedented levels. We try to calibrate that in the forecast—it is not an exact science—through an assessment of uncertainty. The reason I made that comment was precisely in that context. It is the forward guidance that we have had in place since the second half of last year to say, given the uncertainty around the evolution of the economy, we will need to see the evidence more sharply than we normally might do.

A piece of good news is that that level of uncertainty is now beginning to reduce, and we reduced the level of uncertainty in our latest forecasts. The path will become a bit clearer, but there is still a lot to be done to get us back into a more normal situation. As I said in the answer to Lord Monks, we are keeping a very close watch on this, and there is a very clear difference between that remark I made and, as Ben was describing, other monetary policy frameworks.

Lord Bridges of Headley: Can I press you a bit further? In practical terms, what does that mean? What is "more evidence"? I might have missed it in the previous answer, but what more do you need?

Andrew Bailey: Particularly during the Covid crisis the evidence was not always easy to see, because there was so much uncertainty. Probably the best example is the labour market. It has been very hard to read what has been going on in the labour market for a number of reasons. It is no criticism of the ONS whatever. It has been harder to collect the evidence than is usually the case, because there is a degree of interviewing that has to go on to decide whether people are searching for a job or not. The furlough scheme had a big effect, by the way, but it sort of disrupts the normal relationships in the labour market.

We have had to try to pick our way through that body of evidence to determine what is going on, and that is important. In our forecast 10 to 12 days ago, we lowered our profile on unemployment substantially. That was a very important judgment that we made. It has been hard picking our way through that evidence, because it is more than usually uncertain.

The Chair: As someone who was active in politics at the end of the 1970s and during the 1980s, I find myself wondering how sustainable the current policy of loose monetary policy and expansionary fiscal policy is. When the Bank says it thinks that inflation will go up and come back down again, I remember that once inflation gets to a certain level it becomes very difficult to control. It is like hanging on to a slippery fish. Would you comment on that? It might make me feel a bit easier.

Andrew Bailey: There are two things. Let me take something Dave said a little while ago, which is why we spend so much time looking at inflation expectations. There are a whole variety of ways of looking at them—through surveys and through financial markets. You are right: what concerns us most is if we think the embedded expectation of future inflation is changing and increasing. Now, we do not see strong evidence of that at the moment, but we have to watch that very carefully.

On the point about the 1970s and 1980s, the last 14 months, roughly, have been absolutely unprecedented in terms of the impact on economic activity. It goes back to my point about consistent and complementary policy. The fact that we are seeing fiscal and monetary policy operating in the same direction should come as no surprise in the face of a shock of this nature. They are both countercyclical policies. They have both been operating to their risk in their respective frameworks, and I do not think that should be any surprise. But, of course, as it comes to an end, and we are all hoping it is, that will take us into a very different position.

Q196 **The Chair:** I should give apologies for Baroness Kingsmill, who indicated that she had to leave for another engagement and was not able to ask her question. Perhaps I could ask very briefly,

Governor, do you agree with Charles Goodhart and Manoj Pradhan that demographic trends such as an ageing population could lead to a new inflationary pressure?

Andrew Bailey: Yes, I will come to that. I am sure Ben and Dave will want to comment as well. Charles Goodhart has written a very interesting book on the subject, which says that one of the reasons why we have had structurally low interest rates over the last decade is because we have had a period of ageing populations globally. We have also had quite a substantial increase in the world's labour force, particularly with the change in China. Ageing population increases demand for saving relative to investment. Those things will come to an end.

However, even if you subscribe to that view, the book makes the point that these are pretty long-run trends. We are not going to wake up next month and find it has happened.

Dr Ben Broadbent: I agree completely. You made an important point that, apart from the slow-moving trends, it is global. We operate in a global capital market, and what matters for our so-called equilibrium interest rates are forces on global saving trends and investment demand, not simply our own. I do not think the ageing of the UK specifically, the UK accounting for probably less than 4% of global savings, will have much impact over time. It is really what happens in the world economy in that respect.

The Chair: Thank you for that. Lord Livingston.

Q197 **Lord Livingston of Parkhead:** I want to follow on from this. It seems a long time ago since it happened—this notion of having to raise the Bank's rate in order to dampen future inflation. When we discussed it in the context of the impact on the PSBR because of the money that the APF had held, I think Ben Broadbent was pretty relaxed and he was using an example that if the yield curve went up along the whole yield curve it really did not change things. But, of course, it does change things. If there is a rise in the Bank's rate it has an immediate impact now because of the amount of QE that has been done. A 1% movement in the bank rate—I think that was the figure you quoted—would be about a £20 billion effect on the PSBR.

In that light, because there are people who might worry about that, particularly in the Treasury—you mentioned Charles Goodhart a second ago—do you have a view regarding his proposal that there might be circumstances in which you would say that you pay nothing to the banks on the reserves held to fund QE?

Andrew Bailey: I will start—

Dr Ben Broadbent: Would you mind if I very quickly stepped in and corrected that number? Forgive me for coming in. Twenty billion pounds is the figure for the total increase in the Government's debt interest payments if interest rates went up by one percentage point. It is not the effect of this QE bit of it. Just to be clear, what QE does, as you say, is to accelerate the effect of changes in interest rates. The fact that a total over the last 10 years or so of £112 billion—that was the number, I think—has been handed from the APF to the Treasury is an illustration of that. Ultimately, it has no impact—the maturity of the debt and therefore the fact of QE—on the eventual number that results from a change in interest rates short and long. It simply speeds things up. That was the point I was trying to make. Imagine we change Bank Rate by—

Lord Livingston of Parkhead: Speeding things up is quite important to the then current Government. Do you accept that?

Dr Ben Broadbent: I understand, but it is not £20 billion. One per cent of the APF would be the number.

The other thing I would like to say in that respect is: do not take these things in isolation. In the background, the maturity of the gilt stock has gone up, which moves in the other direction. What is also true is that you have to think about why interest rates might do what they do. The fact is that you tend to get rising interest rates in an environment of stronger growth. Stronger growth brings in more taxes and generally reduces the deficit. That is why the deficit is, overall, countercyclical. This effect is always there.

If we ease monetary policy, it reduces the cost of borrowing for everybody, including the Government. That is true even before QE. That is true when we were just controlling short-term interest rates. But that is usually and significantly outweighed by the effect of the cycle on tax receipts. Think of that £112 billion that has been handed over from the APF to the Treasury over the last 10 years. It has not stopped the Government running large deficits. That is because the economy has been weak on the whole. Similarly, if the economy is strong enough to justify a higher interest rate, it is likely that tax receipts will go up and the deficit will fall, notwithstanding the direct effect of interest rates on these payments. One really should not see it in isolation, I think.

Lord Livingston of Parkhead: Albeit that I am sure I remember stagflation once upon a time. In the event that it creates a pressure on the PBSR, I think, Governor, that you have been quoted publicly as expressing not a great deal of enthusiasm for Charles Goodhart's idea of paying nothing on bank reserves. Could you expand on that and say whether it is something the Bank has looked at at all?

Andrew Bailey: We have seen a number of proposals around that sort of theme. Some of them have been put to you in submissions. I would say two things. First, it is actually fiscal policy; it is a tax on the banking system. It is not monetary policy; it is fiscal policy.

Lord Livingston of Parkhead: So, if it is not a question for you, is it a question for the Chancellor?

Andrew Bailey: If that decision were to be taken, it would not be a decision, in my view, for the Bank of England.

The second question is a monetary policy point. It would complicate the transmission of monetary policy substantially, because that begins with us setting the short-term official rate—the official Bank Rate. That transmits through the interest rate we pay on the reserves that banks hold at the Bank of England. That would cut off however much of that channel, depending on how the policy was implemented, but it would complicate and weaken the implementation of monetary policy. So I am afraid I do not support it.

Lord Livingston of Parkhead: I assume it goes with other ideas such as changing the term compulsorily. You would put many of the same challenges back on those ideas.

Andrew Bailey: Broadly, they are all ideas around the same theme.

Lord Livingston of Parkhead: Can I go back to the beginning to communication and the issue that the amount of QE and the amount of debt being raised are eerily similar? A number of witnesses—and you have also heard some of the comments made, for example, by Goldman Sachs—have expressed with absolute certainty that this is because it is co-ordinated; and a number of witnesses have expressed with absolute certainty that no, it is not.

Do you not feel that perhaps, given the coincidence of the amounts, the Bank could have done more? Quite a range of market participants and non-market participants are absolutely sure that you have basically been co-ordinating the level of QE with government debt. You have been very clear that you were not. Bearing in mind that so many people think you were, perhaps looking back, do you not think you might have done it a bit differently?

Andrew Bailey: Can I make a number of points on this? There is no evidence to support this. First, in five out of the last 12 years in this country that basic pattern of relationship has held where the Bank has been doing QE. It is not a surprise because of the point we have made several times about consistent policies.

Secondly, I have read a lot of the submissions and transcripts. As far as I can remember, nobody has said that the obvious thing to do is to read the minutes. For example, the minutes of the meeting of 19 March last year when we made the large QE announcement are published. I would suggest to anybody that, if you want to understand the decision, start with the minutes. They are a pretty comprehensive explanation of what we were facing that day.

The third point is this. Take yourself back to 19 March last year. Nobody knew at that point what the fiscal deficit was going to be. I do not think the Chancellor knew what it was going to be. I do not think the Treasury knew what it was going to be. The Bank of England certainly did not know what it was going to be. So it is just impossible for us to have fixed QE at that point to have matched fiscal deficits and the borrowing requirement. Nobody knew what it was, because the major economic effects of Covid had not happened at that point. It is beyond far-fetched, if you do not mind me saying so.

Lord Livingston of Parkhead: We listened to a large number of witnesses. You have made the point really clearly as to why it is not true, but it does raise that communication point. Thank you, Governor, for that.

Andrew Bailey: It raises a communication challenge—I agree with you—but I am afraid the answer is pretty straightforward.

Viscount Chandos: I am conscious that I set the hare running by suggesting that you could see £110 billion given back in a single year. The point I was trying to make—and I was looking not at the £2 trillion of total government debt outstanding but, say, at the £800 billion held by the APF—is that it would only take a move of the 10-year gilt yield towards 3% for there to be a mark-to-market adverse swing of about £100 billion, by my calculation, looking at an eight-year maturity. It seems to me that the challenge for the Bank then, at a time when the governor and the Chancellor cannot just talk about Covid and there is pressure on the Bank to avoid crystallising that loss, will be intense.

First, I wanted to suggest that scenario of giving back all the gain in a year or two and a huge hit to the Government's budget at that point, but also to highlight Lord Macpherson's point that that is when the pressure on the relationship becomes even more intense.

The Chair: Do you want to deal with that, Governor, or does Ben want to comment?

Andrew Bailey: I am not sure I will deal with it, but I will certainly answer it. Going back to something I said earlier, that is why it is important, in my view, that when we get to that point we pre-announce the approach we would take. To coin a phrase, it is on autopilot. In that way, it is predictable. Frankly, you and the House of Commons can hold us accountable and can see it. You can see if we diverge from it.

Let me give you an example—and it is only an example—of what we could do, and just be clear that no decisions have been taken. It is not even being discussed at the moment. We could say in the future that we will cease reinvestment. Over a period of time, that would bring down the stock because a third of our holdings are short-noted gilts. Over a period of time the stock would come down as most of the gilts mature and we did not reinvest. Part of what we are doing at the moment is, of course, reinvestment to keep the stock at its constant level. That would be an example of something we could do, which would not require us to intervene meeting by meeting. It would just operate to a rule, as it were.

You would have to have an override if we had another pandemic or something. I hope we do not, but, to my mind, that would be a way of substantially defusing the point you rightly make, which is: how to avoid making this contentious?

The Chair: You said that you could do a number of things. Was that the only thing you were going to mention?

Andrew Bailey: Yes, sorry. That is it.

The Chair: If there are no more questions from Lord Livingston or Viscount Chandos on that, we can now move on to climate change and Lord Stern.

Q198 **Lord Stern of Brentford:** Thank you, Chair, and, Governor, Ben and Dave, for joining us. It is very good to see you. I should say at the beginning, for transparency, that the governor and I had a discussion for about an hour in January this year, which is on the Bank of England's website.

The first question on climate change concerns the way in which the Bank's particular tools and the way of understanding climate change come in most strongly. The network for greening the financial system, as we know, started in 2017 after quite a long discussion among central banks way before this episode of QE. They identified investment, financial stability in regulation, stress testing and scenarios of dislocation in labour markets and so on.

Within that broader framework in the NGFS, of which the Bank of England was a key founder member, where do you see corporate QE as being important in relation to this new mandate for the MPC in the context of the other issues that come in that you are dealing with in relation to climate change?

Andrew Bailey: In the context of the MPC's remit, let me tell you about the change the Government made in the Budget. Nothing changed in terms of the structure of the remit. The remit remains price stability and subject to that—important words "subject to that"—and other policies of the Government where relevant. The remit letter I get from the Chancellor then sets out what the Government's policies are that are of relevance. The change was simply to add climate change and its economic effects to the list of policies. So there was no change to the structure of the remit.

It is relevant for two reasons in my view. One is the likely impact of climate change on financial stability and that part of the financial sector that we regulate—banks and insurance companies. The second, as you rightly said, is the potential impact of climate change particularly on the supply side of the economy, which will become an issue for monetary policy, all things being equal.

You have been the leading light in this field and remain so. Developing economic scenarios that, in a sense, calibrate and put into effect climate change is something that we are doing in the network for greening the financial system with other central banks to develop scenarios that we can use in the exploratory scenario. We won't call it a stress test.

You asked about the corporate bond portfolio. We do not hold a very large portfolio of corporate bonds under QE. It is about £20 billion. The approach we took when that portfolio was built up in two parts, actually, was to construct it on a neutral basis in the sense that it is sterling corporate bonds. There is a minimum credit-rating quality. Above that, we hold a neutral cross-section of the market—in other words, of the issuers in the market.

We will issue a discussion paper this week, or if not this week then next week, which says what would be a sensible approach to maintaining the neutrality of the portfolio but including in the definition of the neutrality a mechanism taking into account the direction of the change towards net zero. It is not saying, "Is the company green today or not?" That is not a sensible way of doing it. "Is this company adopting, or will it adopt in the future, policies that make it consistent with government policy of net zero?"

That is not a straightforward thing to do. We have discussed this. We will be issuing a discussion paper on it and I am looking forward to the responses we get. But that is how we are interpreting doing it, and we are aiming to get that approach in place before we do the next rebalancing, because we have to rebalance the portfolio every year when we get maturities and so on. That is coming up in the autumn, is it not, and Dave will correct me if I am wrong?

Sir David Ramsden: Yes. We need to do another set of investments in 2021 Q4. That gives us good time to get the responses to the discussion paper that we are putting out imminently and to take account of those as we think about how to modify—as you say, Andrew—and adapt the CBPS to take account of the climate aspect of the issuers of the bonds that we hold in the corporate bond purchase scheme.

Lord Stern of Brentford: Thank you very much. I look forward to that discussion. Of course, the notion of market neutrality when you have a whole series of fundamental market failures beyond the greenhouse gas emissions one is quite complicated, and I am very happy to discuss that.

Andrew Bailey: We are hoping that you will help us out with a solution to that.

Q199 **Lord Stern of Brentford:** I will try. I generally believe in responses rather than solutions, but I will do my best.

The second part of the question is taking on the issue where you do your analysis and your actions. How far do you think there is a risk of taking on the things that the Treasury or BEIS should be primarily responsible for? Do you think that is just pulling you further down the line of what people would call quasi-fiscal?

Andrew Bailey: That is a very interesting question. To be clear, I do not regard the Bank of England as the lead authority on climate change in this country by a long way. That is not our job. There are areas of it where, consistent with what I said earlier, we need to take it into account in a policy environment. In taking it into account, there will be a feedback mechanism and a loop, if you like, in terms of shaping the way in which the financial sector responds to climate change and how we take into consideration the impact of climate change particularly on the supply side of the economy. They are highly relevant questions. But please be very clear: we are not the lead authority on climate change by any means and never will be.

Q200 **Lord Stern of Brentford:** Thank you. The third part of the question is whether this in any sense takes you away from your primary mandate—that it reduces your bandwidth or your attention, or is diversionary in some way. Do you think that adding this to the things you have to think about makes it harder to achieve the primary mandate?

Andrew Bailey: I would respond to that by saying that we will have to think about it anyway, because we have to think about the impact of climate change on the asset portfolios of firms that we regulate. The Bank of England's work on climate change originated in, I think around about 2014 or 2015 in work that we did on the impact on climate change on the asset portfolios of insurance companies with the insurance regulator for financial purposes, because they are very long-term asset holders, particularly life insurers. It was clear that the horizon of climate change was coming to the point where it affects them. It was something that we felt we had to take into account. That has now moved into the world of banks.

The interesting issue that has not really come into question so far but is doing so increasingly is the point about the supply side of the economy as the horizon gets closer in monetary policy. Obviously, monetary policy has a shorter horizon generally. Increasingly, central banks are saying, "We need to factor that into our supply side assessment". That is natural; we have to do that anyway, frankly.

Lord Stern of Brentford: So you could not really pursue your primary mandate properly without taking that into account.

Andrew Bailey: No.

Q201 **Lord Stern of Brentford:** The last part is a very big question and much more open-ended, but we do not have a lot of time so we have to be quite quick with it. It is really the appropriateness of the mandate as a whole. As you reminded us, and it is tremendously important, the independence of the Bank was established nearly 25 years ago in the late 1990s, and the economic structures have changed radically since then. Think of digital and demography, and now net zero, which will be a big part of the changing structure.

As to the risks that we now realise are out there, perhaps we should have realised them before. I do not think that the magnitude of the very big risks that we face, which have materialised in the last dozen or so years, was fully understood at that time. It is also true that the economic and social objectives of government have developed and deepened—the sustainable development goals, such as 2015, which apply to the UK and which the UK was a leading figure in establishing as the objectives of economic and social policy.

Your reaction to this is very important. You could argue that the structure of the economy has changed and will change very strongly. The nature of the risks that we face we now understand a bit better and are much bigger than was anticipated then. We have a broader and deeper view of the objectives.

In your view, where does that leave the relevance of the mandate of the bank? Is it absolutely fine, should it stick where it is, or should we be having a public discussion about that?

Andrew Bailey: I think price stability is a timeless mandate. Things will inevitably change around it, but I think the public good of price stability is timeless in that sense, as is the public good of financial stability, which we came to rather later and after a very difficult experience. At that level, I see those public interest objectives and public good objectives of central banks as timeless. In a sense, they hold whatever goes on around them.

In terms of how they affect what we do, yes, we do. I will advertise another discussion paper that we will issue at some point in the next month or two, I hope, which is on the whole question of digital currency—not on the technology but on the pretty profound issues that raises for financial stability and monetary stability depending on which way it goes, which in my view have been given far too little consideration in the rush of enthusiasm to discuss all the bits of technology and cyber this and that. I am very keen that we get back to what I might call the more fundamental issues that are absolutely crucial to this question and as to where we should go. I think we have to go on tackling those questions as the world changes around us, frankly.

Lord Stern of Brentford: Thank you very much.

The Chair: Governor, on that point about digital currency, it may very well be an issue that the committee will turn its mind to.

Following on from Lord Stern's question, I can see why the Bank would have a role in prudential regulation—people lending money on projects that will be less viable as a result of climate change, and the impact of climate change—but we had evidence as a committee that the green mandate is in danger of putting the central bank in the position of choosing and making value judgments about green winners and losers.

I will quote you Liam Halligan, for example, whom you will know is a journalist. In his evidence, he said, "Once the Bank starts buying corporate debt it is making very political decisions. It will often be buying that debt in distressed circumstances and the Bank will then be judge and jury on which companies should survive and which should not. I do not think that that is what any single bank should be doing, least of all ours". What is your reaction to that?

Andrew Bailey: The decision to buy corporate debt goes back a few years now. The logic for doing it, as I understand it, was that it would help to facilitate financing conditions for companies. It goes back to the point about the impact of a QE policy on the cost of finance.

The reason the market neutrality approach was taken in a sense to counteract that sort of thing, because—you are right—the last thing we want to be is the picker of winners and losers. I do not want us in that position. We do not remotely want to go there. As I said to Lord Stern, and this is what the discussion paper will be on, the challenge for us—and it is one we will take on—is whether we can adjust that neutrality approach to take on board another piece of an objective of public policy, which is climate change. I think we can, but it will not be straightforward. But we are absolutely not picking winners and losers either in terms of credit quality or greenness, to use that terrible word.

Lord Stern of Brentford: For clarification, that was the reason I emphasised market neutrality and the difficulty of the meaning of market neutrality.

Andrew Bailey: Yes.

Lord Stern of Brentford: It is not the same question as picking winners and losers.

Andrew Bailey: Absolutely.

Q202 **Lord Skidelsky:** You talked about the timeless importance of price stability. I would agree with that. But we heard from Sir Paul Tucker that the correct division is to have the Treasury do the stimulus policy, with the Bank acting as a check on any excessive spending by the Government. That was how the system was set up, and the horses have changed jockeys, so to speak, since 2009.

Andrew Bailey: With all due respect to Paul, who is a long-standing former colleague, I think that is just a wrong interpretation of what the MPC was established to do. I read it, and I read it with interest, but I was somewhat bemused by where it came from. I do not know whether Dave or Ben want to add anything.

Dr Ben Broadbent: If you look back through history, and I mean hundreds of years of history in this country, the best way to stabilise inflation involved leaning against swings in demand. That is very clear in the theory because of the basic Philips curve relationship. It is very clear in our history. Monetary policy has been most successful in stabilising inflation.

By the way, that has happened over the last 25 years in which inflation has been more stable than in any quarter-century period in the 800 years for which we have estimates of consumer prices in this country when it has been countercyclical. It has been more countercyclical now than at any point in history, and more successful in stabilising inflation. Otherwise, to find a vaguely similar period in which inflation was reasonably stable, you have to go back before the First World War and the gold standard, and there, too, interest rates were more cyclical than they had been in the intervening 70 to 80 years.

I simply think it is a false dichotomy to say that either you stabilise activity or you stabilise inflation. Most of the time you do one by doing the other. So I would agree with Andrew in his assessment, and I think it is pretty clearly borne out by our own history.

Lord Skidelsky: There is a question of history; there is a question of theory. We do not have time to go into both of them now, but I do not entirely agree with what Dr Broadbent just said.

The Chair: If Lord Bridges does not want to come back on an earlier issue, does anyone have any further questions? I am very conscious that both the deputy governors have been very restrained. Is there anything, Ben Broadbent or Dave Ramsden, that you want to add that has been lost or fallen down the grating during the last two hours?

Dr Ben Broadbent: One tiny thing, and I will hand over to Dave. Maybe we can write to Lord Chandos with a few of these points on the sensitivity of flows in the APF according to movements in interest rates, which I think might help. Otherwise, I just wanted to thank the Committee.

I have been on the MPC for almost 10 years. It is a job we are honoured to do and every MPC member takes the responsibilities involved in meeting the remit extremely seriously. For us to maintain the credibility that happily the regime has enjoyed, a vital part of that is that we are individually and collectively accountable to Parliament, and that is why sessions like this are very valuable for us and our regime. Thank you.

Sir David Ramsden: Could I add, Lord Forsyth, to an answer Andrew gave earlier on accountability? As to the different things we have done this year in the context of quantitative easing, there was the publication of the Bank's Independent Evaluation Office report on quantitative easing. I know you took evidence from Melissa Davey, who is the director of that office. That was an additional thing that we tried to get out there, back to what Ben was saying, for transparency and communication in what we do, and accountability for it. I hope you found that report and the way we tried in our written evidence to address the issues you raised, as well as today's hearing, have helped. I am sure that there is more we need to do to be accountable on QE, but we understand that it is an ongoing process and we will do our best to continue to add information as we can.

The Chair: I think the whole committee will recognise, having spent the last five months or whatever it is, looking at these issues and taking evidence, what a great job you do and how this is not a simple subject. I hope we will be able to produce our report before the Summer Recess.

It is three minutes past five. That is not bad, considering the number of questions. I thank you, Governor, for coming and answering our questions, some of which I am not sure actually have answers at this stage. To the two deputy governors Ben Broadbent and Sir Dave Ramsden, thank you very much for this very useful session—our last session in this inquiry. That concludes this session of the committee.

Andrew Bailey: Thank you for an excellent afternoon.