House of Commons

Treasury Committee

Oral evidence: Bank of England Monetary Policy Reports, HC 142

Monday 24 May 2021

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Harriett Baldwin; Anthony Browne; Felicity Buchan; Dame Angela Eagle; Emma Hardy; Julie Marson; Siobhain McDonagh.

Questions 130 - 217

Witnesses

I: Andrew Bailey, Governor; Sir Jon Cunliffe, Deputy Governor for Financial Stability; Andy Haldane, Chief Economist; Michael Saunders, External Member, Monetary Policy Committee at the Bank of England.

Written evidence from witnesses:

Andrew Bailey's annual report to the Treasury Select Committee

Sir Jon Cunliffe's annual report to the Treasury Select Committee

Michael Saunders' annual report to the Treasury Select Committee

Examination of Witnesses

Witnesses: Andrew Bailey, Sir Jon Cunliffe, Andy Haldane and Michael Saunders.

Q130 **Chair:** Good afternoon and welcome to the Treasury Committee evidence session on the lessons from Greensill Capital and the Bank of England's *Monetary Policy Report*. I am very pleased to be joined by four witnesses from the Bank of England this afternoon, and I am going to ask them to introduce themselves very briefly to the Committee.

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

Sir Jon Cunliffe: I am Jon Cunliffe, deputy governor for financial stability.

Andy Haldane: I am Andy Haldane, chief economist at the Bank of England.

Michael Saunders: I am Michael Saunders, external member of the MPC.

Q131 **Chair:** Welcome to all of you and thank you for joining us today. As you know, questions will generally be directed specifically at one or more of the panel, but, if there is anything that you want to add and you have not been invited to express an opinion, do just raise your hand and I will bring you in at that point.

Could I start, Jon, with you and Greensill? I want to try to understand better what your thoughts and what the Bank of England's thoughts were about what Greensill was trying to achieve with its attempt to access CCFF. They said—we have heard evidence to this effect—that this was about trying to get money and liquidity out to small and medium-sized enterprises, but when it came to the iteration of the proposals that were considered that would have allowed CCFF access to Greensill clients, provided that those business were investment grade prior to the pandemic, and allowed Greensill to then use this funding for supply chain finance, were you surprised, therefore, that they declined that particular structure? Why do you think they took that decision?

Sir Jon Cunliffe: It might be helpful if I give the broad context. At the beginning, when Greensill approached the Bank of England, we were certainly concerned at that point about finance for small and medium-sized businesses. We saw what happened in the financial crisis when they lost access to working capital and were unable to finance the gap between producing services and being paid by their clients. That has been a concern right throughout the first phase of the crisis: could we ensure that finance was available for SMEs?

When we had the first approach, I have to say that I did not know much about Greensill and supply chain finance, but we were very keen to understand what they did, whom they did it for, whether it was a general problem and, indeed, whether we were starting to see problems with small businesses that could not access supply chain financing, invoice financing or other ways of dealing with their working capital. The proposal—you have discussed this with other witnesses—was that actually Greensill was a large player and that a lot of SMEs depended on it, and that if it was unable to provide this finance, or even to gear it up, there would be a problem maybe similar to some of the problems we had seen in the financial crisis for SMEs that were short of working capital.

It was right to try to ascertain whether there was an issue there. It was right to try to investigate whether there was a general problem with supply chain finance. I will be honest: we did not know or have the information. One of the things we told the Treasury early on is that it is very difficult to get a precise estimate of the number of SMEs that depend on this or, indeed, the number of SMEs that depend or depended on Greensill. The call for evidence on the general scheme identified a number of things, some of which we knew, including that the majority of this sort of finance is still done by banks, not players that securitise the assets in the market. It turned out that Greensill was very much in favour, but there was not really general support for it.

Interestingly—this may have been a function of how the situation developed—others did not see the need for it and said that they were not really experiencing the same sort of problems. As the period progressed, it became clear that the development of bounce back loans and other forms of getting finance into SMEs was meeting the need. By the time we came to the response to the call for evidence, I do not know whether "surprise" is the right word, but it reconfirmed that there was not a general problem here. If something needed to be done, it was for the Treasury to decide whether it wanted to do that. We were only ever the agents of the scheme advising it. By the time we got there, the Treasury had finetuned and developed a number of other mechanisms that essentially did the same thing.

SMEs being short of finance in a crisis where demand has dried up entirely and needing to survive is what caused the real problem in the credit crunch back in 2008-09. That is what we were trying to avoid. As proposed to us, Greensill was trying to help solve that problem. It turned out that there was not a problem in the way there had been in 2009, and supply chain financing and invoice financing continued through the period, supported in large part by the banks. Again, this goes back to that key difference. This time around we ensured that credit continued to flow to small businesses.

Q132 **Chair:** There were at least four iterations of the original proposal that you discussed with Greensill. One of those iterations, it seems to me, would have allowed Greensill to have access to CCFF for the purposes of getting supply chain finance out to investment grade businesses, but it declined to enter into that arrangement. I am just curious as to why you think it declined at that stage to do that.

Sir Jon Cunliffe: My memory is that the first Greensill proposal was that the CCFF just bought the commercial paper issued by Greensill's special purpose vehicles. That was clearly outside the rules of the scheme. When the Treasury declined to change the rules of the scheme, because it was not really fitting what the scheme was intended to do, the Treasury asked whether we could look at other proposals in which the corporates that could access the CCFF, the large corporates and investment grade corporates, could draw from the CCFF and then, once they had drawn from the CCFF, they could use that, if they wanted to, to support Greensill by buying the commercial paper issued by Greensill.

We confirmed that that would be in line with the scheme. It was for the corporates to decide what they did with the CCFF drawing. If using the finance to buy Greensill paper was the best way for them to pay their suppliers, that would have been within the scheme. That did not work for Greensill.

Q133 **Chair:** Why?

Sir Jon Cunliffe: I do not know. I am not an expert, but I assume it was because it was not attractive for the corporates involved. They did not actually want to buy the commercial paper from Greensill directly. The whole scheme had been set up so that investors bought that paper and that was what was used to finance the early payment of the large corporates' supply chains. I assume it just was not attractive to them.

It is conceivable that, had they done that, it would then have registered as debt, because they would have drawn from the CCFF and that would have changed their debt numbers. It is possible that they did not want to see their debt increase at that stage. They may have just felt that they did not have a problem and their suppliers would manage with the use of other facilities.

I do not know why Greensill decided that that would not have worked for it. It would have been within the terms of the scheme for a large corporate to borrow and then to use the borrowing to finance early payments to its suppliers. That would have been within the scheme.

Q134 **Chair:** Did you suspect at any point that Greensill's preference for the SPV—special purpose vehicle—with credit insurance involved as well, was really about driving to have sub-investment grade assets within the arrangement so that it was not just those of investment grade that Greensill could support through getting access to CCFF in that way?

Sir Jon Cunliffe: I was not in the meetings with Greensill and Greensill employees, so I did not get involved in those discussions. They were talking about both investment grade and non-investment grade, and, as I recall, they were prepared to have access just for investment grade.

They failed the CCFF terms of access primarily because they were a financial firm and it was not designed for financial firms, but also because some of what they did was sub-investment grade with an insurance credit wrapper. My recollection is that they were prepared to structure it just for investment grade corporates. Again, you would have to ask them about their motivation, but I do not recall sensing at the time that it was specifically about it being sub-investment grade.

Q135 **Chair:** The Bank of England's own analysis at the time stated that "any lending by Greensill would probably be focused on allowing sub-investment grade larger companies to increase leverage", so it does look that they were trying to push down that route. That was not something the Bank or the Treasury was prepared to entertain; however, they seem to have been pushing to try to get that in place. Having analysed it at the Bank, I am just wondering what you thought they were up to. Why were they trying to do that?

Sir Jon Cunliffe: In general, they had an issue that they could not sell the commercial paper. The markets froze for commercial paper. At the beginning, they simply could not sell the commercial paper that they needed to in order to finance the operation. That was the initial driver. The markets were completely closed. They also hoped—this was said at one point—that if we bought the paper somehow the markets would have confidence in it, the market would come back again and the like. One motivation for them was finding a buyer.

Given that corporates and others with an investment grade rating had access to finance and there was plenty of other access to finance, it may have been that they would have tried to target this on sub-investment grade, but of course we never got to the discussions with them about whether we would be prepared to accept that—actually, that was outside the scheme—because we never got to that point. It is possible that that is where they wanted to go, though.

Q136 **Chair:** On the sub-investment grade access point, there was a readout of a call between Lex Greensill and Charles Roxburgh at the Treasury on 30 March 2020 that noted, "In addition he"—that being Lex Greensill—"claimed that all the companies in their proposed asset bundle bar one would be eligible to access the facility"—that being CCFF—"in their own right (in other words without needing a credit wrapper to secure eligibility)". Who do you think the "bar one" was? What was that reference? It was clearly a particular company.

Sir Jon Cunliffe: I have no idea. That was not discussed with us. I had no discussions on that.

Q137 **Chair:** Would the Bank not have speculated, had internal discussions and tried to think about who that might be?

Sir Jon Cunliffe: At that point, the Treasury was discussing with Greensill. We had told the Treasury that it fell outside the rules of the scheme. They had to reach their conclusions about whether, in policy terms, they wanted to widen the access. We told them where we thought the risks lay and how we thought it fitted with the scheme itself, but I was not in those conversations with Roxburgh. I had no conversations with Greensill.

Q138 **Chair:** At the time, although you were not involved in them, were you familiar with the details of those conversations?

Sir Jon Cunliffe: That particular conversation, no, probably not. I was in close contact with Charles Roxburgh throughout the period, but I cannot recall whether I ever saw that particular note. I am pretty sure I was not asked who the "bar one" was, and I do not want to speculate on who the "bar one" might be. People will draw their own conclusions.

Q139 **Chair:** We all draw conclusions. We are particularly interested in what your conclusions are now. Did you discuss GFG, the Gupta Family Group, or concentration risk around Greensill with Lex Greensill, David Cameron or anybody else, or internally at the Bank?

Sir Jon Cunliffe: No.

Q140 **Chair:** Were you aware, at the time, of the issues that I believe were raised by a foreign regulator through an approach to the RPA in March 2020? Was that something you would have been familiar with?

Sir Jon Cunliffe: I sit on the PRC, the Prudential Regulation Committee, which does the regulation of UK banks. I was aware from before the Covid crisis of the issues around Wyelands Bank. I was aware of the connection with GFG. I certainly had that history throughout, but not from the Greensill application or any other conversation – well, I had one conversation with David Cameron – on the PRC side.[1]

Q141 **Chair:** Would it not have been reasonable to expect, though, a joining-up of the dots here? There are these issues potentially around GFG Alliance; there is Wyelands Bank, which is Mr Gupta's bank. You have an intensive lobbying exercise around trying to raise money and not restricting that just to investment grade businesses. Did those dots not get joined up in the Bank?

Sir Jon Cunliffe: Those dots certainly were joined up in the Bank and in my mind. I knew about GFG; I knew about Wyelands. There had been a lot of press speculation—this did not have to be all commercially confidential or supervisory information—about the role of Greensill. Of course, this changed over the period. The information that you refer to from a foreign supervisor came in February 2021.

I certainly knew about all of that. I did not know what was happening within Greensill—Greensill is not regulated or supervised by the Bank of England—or what was happening within GFG, because we do not have information about what happens in private firms. We were certainly

[1] The Bank has contacted the Committee to clarify that Sir Jon was aware of issues around Wyelands Bank and the connection with GRG from his position on the PRC, but not from the Greensill application or his conversation with David Cameron, which was on supply chain finance only.

aware of all of those possible connections, and we were aware of the reputational issues that might be associated with that nexus. That was part of our assessment, but we had no actual evidence of what was going on within Greensill. Indeed, we do not now. We had no access to that, and we had no access to what was happening within GFG, other than what we could see through Wyelands Bank, but the dots certainly were connected.

Q142 **Chair:** I am going to bring in Andrew in a minute, because I know he wants to come in. Did you share that joining-up of the dots or the overarching assessment that you would therefore presumably have of Greensill and Gupta with the Treasury? Did you discuss those concerns and issues with the Treasury?

Sir Jon Cunliffe: The Treasury was aware. We advised it. Greensill made his application to the CCFF, and then we advised the Treasury on his application to change the terms. We looked into his business model on the basis of the documents that he had sent us. As I say, we do not regulate or supervise; we do not otherwise have a line of sight.

We advised the Treasury on what we knew. Remember that this was in the middle of a crisis, so it was moving quite quickly. We advised the Treasury on what we knew about the SME chain, the size of the SME need and the commercial paper market. We did not know anything about Greensill's involvement with the NHS, pharmacists or the Earnd scheme for pay. We made clear to the Treasury that that was one of the points made to us by Greensill, but we could not tell it what would happen to the NHS if Greensill could not operate. Clearly, it is easy to find that out within Government. We explained where the risks were in expanding the CCFF as Greensill had asked for and why it did not qualify.

We explained, although the Treasury was aware, about the reputational issues. Remember that investigations are going on, so we still have no firm evidence of what actually happened within either GFG or Greensill; that will be for the investigations to discover. Certainly, we made the Treasury aware of all of those points.

Chair: Andrew, did you want to add anything?

Andrew Bailey: You have largely just covered what I was going to say. Just to be clear, from March, when, as you say, we had some information from a foreign regulator, we kept the Treasury informed pretty much continuously on what we knew about the Gupta Family Group Alliance through Wyelands Bank, as Jon said. That built up over time, because in March what we knew about the possible links between GFG Alliance and Greensill was pretty sketchy.

Q143 **Chair:** You are having this conversation with the Treasury. There are various things coming out of the woodwork about Greensill and Gupta. They are lobbying like mad to get access to the CCFF. You are joining up the dots. Did it surprise you to a degree that the Treasury itself at one or two points in this process of proposals was pushing it back to you and saying, "Come on; look at this again"? When one looks at the correspondence around all this, one gets the impression that the Bank is thinking, "Well, none of this really stacks up", yet you end up going through all of these iterations, a call for evidence and so on. The Treasury is perhaps pushing you. Did you feel pressured by the Treasury at any point as well as the lobbying?

Sir Jon Cunliffe: I certainly did not feel any pressure from the Treasury and, if I was lobbied, I was only lobbied a couple of times. I certainly did not feel under any pressure. The context and the timeline of this are important. From when the first approach came in early March until the Treasury said no in late March is a passage of two or three weeks. Then there is another couple of weeks, two or three weeks, while Greensill is trying to amend the proposal to make it fit. After that there is this question about whether something should be done more generally for supply chain finance, and then there is the call for evidence.

In those four to five weeks when lots of things were moving very quickly all over the environment, it did not strike me as necessarily odd that they wanted to come back and say, "Would this work? Is this necessary?" We looked at it and we said, "Well, it does not fit within the scheme. The risks are the same as the ones we gave you earlier". It did not surprise me particularly.

Q144 **Chair:** This is my final question. There are all these different iterations of the proposals. Much of it is outside the way the scheme should work and is therefore a non-starter. You have the call for evidence. There is no appetite in the marketplace, it seems to me, for any particular changes here. Yet a huge amount of effort has gone into looking at these things in fairly short order, involving very senior people in the Bank and the Treasury. Is it fair to conclude at least that, had David Cameron not been involved in lobbying at this very senior level, including the Chancellor and other Treasury Ministers, all of this would have been dealt with far more quickly at least, albeit you may well have come to an identical conclusion?

Sir Jon Cunliffe: I cannot speak for the Treasury. You will have to ask them for their perspective, but, certainly from my perspective, again you have to see this in the context of the period. During this period, I was getting phone calls—I was glad that I was—from financial firms, non-financial firms and people I had known either because I had worked with them internationally and nationally or because they were in the financial sector and some in the real economy. They were explaining what they were seeing and we were trying to make sense of a very fast-moving picture where the economy was literally shut down overnight.

Against that background, other applications to the CCFF required a lot of work. There were other issues coming up that required a lot more work, actually, certainly as far as I was concerned, than Greensill. We gave you a rough estimate in the answer: it involved the work of 2.5 full-time equivalents. I remember spending hours on the phone with some European authorities about one particular company that needed or wanted access to the CCFF where there were incredibly complex issues around state aid and the like.

In the context of everything else that was happening, certainly from my perspective, this was not a huge issue. I was involved with it at the beginning; the team was then involved with it; it came back to me occasionally. It was not taking up a very large part of my day.

Q145 **Chair:** The fact that a former Prime Minister was out there lobbying at a senior level did not lead the Bank of England to invest any more time in this issue than would otherwise have been the case.

Sir Jon Cunliffe: Certainly from my perspective it did not cause me to do any more than I would otherwise have done.

Andrew Bailey: I just have a couple of points. We spent very little time on Greensill relative to the larger time, as the letter I sent said, on the broader issues of supply credit finance. You may remember that during my appointment hearing I actually mentioned supply credit finance as something that we had to watch carefully during the crisis that was taking over. Unbeknown to me, Messrs Greensill and Cameron seemed to pick up on that comment and relay it back to Jon. But it was the broader issues that took our time.

The other point I would make in terms of what we were spending time on, because it does cross over, is that there was quite a lot of contact from non-bank lending firms on the broader issue of whether the schemes were tending to favour the bank lenders over the non-bank lenders. We spent quite a bit of time looking at those questions as to whether they really were important questions for what we were trying to deal with at the time. That took up quite a bit of time.

That is fine. That was a broad industry question, and it is perfectly reasonable to assess the impact on the economy of that question.

Q146 **Siobhain McDonagh:** Mr Bailey, are prospective receivables the latest 21st century development of supply chain finance or clairvoyance?

Andrew Bailey: First of all, inventory financing is a very old financial instrument, which has a very important role. It allows trade to happen; it allows goods to be provided often to people who are either using them or selling them; it has proved its worth. Here is the interesting thing: in its basic form, it is a very straightforward form of financial activity. It is not rocket science; it is not fintech; it does not involve large amounts of innovation. Mr Greensill sometimes presents it as if he has discovered the secret to the universe. Certainly, there was some innovation around it; there may well have been some useful innovation.

I will point to two things that go to your question, which you have to look at with a very sceptical eye. One is this question of financing future receivables, which looks rather like unsecured lending to me. The second one—I know you have heard this in other areas—is the accounting question. While getting accounting done and right is important, there are some suggestions that it has been used at times to make the debt of a company look less than it is and to make the cash flow of a company look better than is. That is of concern. The Financial Reporting Council issued some form of notice in November last year on that question.

There are reasons to be sceptical. There is no reason that the traditional form of invoice financing should not have useful innovation. That is perfectly sensible. To your question, there are some reasons to be sceptical in some areas, yes.

Q147 **Siobhain McDonagh:** Do you share my concern that 50% of the transactions appear to have had no invoice and that the companies involved even regularly did not know that they were involved?

Andrew Bailey: As Jon said earlier, we did not regulate Greensill in any shape or form at all.

Q148 **Siobhain McDonagh:** It is clear that nobody regulated it.

Andrew Bailey: No, it was not regulated. It was outside the perimeter. As the Bank of England, we cannot comment on that. We have no line of sight of it.

Q149 **Siobhain McDonagh:** Do you have concerns? Is this widespread?

Andrew Bailey: I would certainly be concerned, if that turns out to be the case, yes. Obviously, that is deeply concerning.

Q150 **Siobhain McDonagh:** Are you aware of this practice being used in other companies?

Andrew Bailey: We are not experts in this field, so I cannot really comment on that at all, I am afraid.

Q151 **Siobhain McDonagh:** Is there any sort of regulatory failure going on here regarding Greensill?

Andrew Bailey: Greensill was not regulated. From a financial stability perspective, which is the Bank of England's perspective, we have looked at this, because we have a responsibility to look at the perimeter from the point of view of financial stability. We do that regularly. Jon and I have both been doing it pretty much throughout the life of the Financial Policy Committee.

I have to say to you—I said this in the letter that I wrote—that I have not yet seen evidence that there is a case for regulation on the basis of financial stability in this situation. As you know, commercial lending is not regulated. While there may well be, when the evidence is all laid out, some very difficult and regrettable practices, the fallout from the failure of Greensill is not systemic. It is not suggesting a failure of financial stability either in terms of the supply of credit to the economy or in terms of the interconnections within the financial system.

For the most part, the Greensill business was refinanced very quickly, mostly, for instance, by the platform provider from which it was operating, Taulia. I am not very good at pronouncing that name; I may have got it hopelessly wrong. I am afraid that the fallout suggests not to me.

Q152 **Siobhain McDonagh:** The FCA was involved with GAM in 2018; it got the investors paid back and then walked away. There was a court case involving Greensill in 2019, because of articles written about it. Then Lord Myners asked several questions in 2019, which the FCA knew about, where he highlighted what he thought was going on. He later described it as a "Ponzi scheme". Do you not think somebody should have taken some notice?

Andrew Bailey: Can we go through each element of that? As you say, GAM was a Luxembourg fund with UK operations. You described that. The rest of the Greensill business was not regulated. There was a bank in Germany, which was not operating in any form in this country, I should say. I am afraid it comes back to the perimeter. If there is a desire to put it inside the perimeter—as I have just said, I have to say that I do not see that myself—obviously that would change the situation.

Q153 **Siobhain McDonagh:** If we turn to Wyelands Bank, the PRA's decision to require Wyelands Bank to repay its depositors in full was unprecedented. Can you tell us a little about the background to that decision?

Andrew Bailey: Yes, I am happy to do that, because it has not really been set out. Let me do that. The problems that the PRA identified in Wyelands began to surface in late 2018 and early 2019. They pointed to a lack of transparency, particularly around connected lending in the context of the ultimate beneficial owner, who is Mr Gupta.

That led to what I would call the first phase of the PRA's supervisory investigation, starting really from the first quarter of 2019. As a result of that investigative work, in September 2019 the PRA imposed restrictions on Wyelands Bank that prevented further lending transactions with certain parties and placed limits on its ability to accept deposits. Those restrictions were subsequently tightened on five occasions in the next 18 months, in various ways.

In October/November 2019, further concerns came to light concerning the loan book. That led to the second phase of the PRA's supervisory investigations. It also led at that point to the PRA notifying the National Crime Agency of its concerns and what it was doing. The PRA then conducted further investigations between that information coming to light in November and around February 2020. Some of those investigations were overt; some were not.

As a result of the evidence that was gathered, in February last year the PRA set out its concerns to the Serious Fraud Office. I cannot comment—I have to be clear—on those concerns, because that goes to the basis of what we believe the SFO is doing, although obviously that is for the SFO. I also cannot tell you what other information they may or may not have.

At that point, February/March last year, the PRA determined that Wyelands failed to meet the threshold conditions for authorisation. That is what is called the first test as to whether a bank goes into resolution. The second test of whether a bank goes into resolution is whether there is a reasonable prospect of the bank taking action that would correct the failure of the threshold conditions. That is relevant, because the board of Wyelands Bank put to the PRA a proposal to enact what we call a solvent wind-down: in other words, it would pay off the depositors.

Q154 **Siobhain McDonagh:** Mr Bailey, I am sorry to interrupt. I do not mean to be rude, but I only have a very short time to ask these questions.

Andrew Bailey: I really apologise, because I do not want to take up all your time, but obviously it is a very important story. I will finish it very quickly, then, shall I?

Siobhain McDonagh: Please, yes.

Andrew Bailey: The PRA accepted the plan for a solvent wind-down in the sense that it would take a year for the money to be put in to match the deposit book. The deposit book had already been shrunk as a result of PRA actions. The money was put in. It was a mixture of loans and a subordinated loan from the ultimate beneficial owner, Mr Gupta. It was programmed to come in with the maturing of assets and then Mr Gupta paid in the subordinated loan on a regular schedule, around every two weeks. By February this year, all that money had been paid in and the bank had cash to match its deposits.

In February, the PRA determined—obviously, the story was blowing up—that it was therefore right to trigger the repayment to depositors and that the cash was there to do it. It did that on 3 March, and by 17 March the depositors were repaid. There is currently about £600,000 outstanding, which is probate cases that cannot be settled quickly. There is matching cash in the accounts of the Bank of England for those people.

That is the story. I am sorry to take up your time.

Q155 **Siobhain McDonagh:** Is it entirely a coincidence that, at the same time as depositors were asked to be repaid, Greensill collapsed?

Andrew Bailey: Yes, but the growing news around Gupta and Greensill means that it was not a coincidence of timing. It is a coincidence of substance but not a coincidence of timing. We determined that leaving the depositors in the bank with the cash on the other side of the balance sheet was not a sensible course of action. On the basis of our statutory objectives to protect depositors, it would not be a sensible thing to do.

Q156 **Siobhain McDonagh:** I just have a very brief follow-up question. Apologies, Chair, I do not normally do this. Sir Jon, you sit on the PRC. Did you see PRC papers relating to the planned wind-down of Wyelands Bank? Did you know that the wind-down was related to delays in repayments owed by entities in the GFG Alliance?

Sir Jon Cunliffe: I saw all the PRC papers on Wyelands and I knew of the issues, as the Governor has said, that caused us to refer this to the SFO.

Andrew Bailey: Could I just make one point here? As a consequence, there has been no loss to depositors and no charge to the FSCS. It is a very unusual operation, but that has been the consequence of it.

Q157 **Siobhain McDonagh:** Yes, but if somebody stole my car I would not just want the police to bring my car back; I would want them to prosecute the people who had stolen it.

Andrew Bailey: We are conducting investigations. Of course, there is an SFO case, as has now been said. You would actually have an affirmative answer to that question.

Sir Jon Cunliffe: I was going to make the same point.

Q158 **Rushanara Ali:** Good afternoon. Thank you very much. I have some questions about CBILS and CLBILS. Starting with Sir Jon, did you or anyone else at the Bank of England suggest CBILS or CLBILS as a route for Greensill Bank to access Government-backed loans?

Sir Jon Cunliffe: No.

Q159 **Rushanara Ali:** You did not suggest it in any of the discussions.

Sir Jon Cunliffe: I was not in the discussions with Greensill, but no.

Q160 **Rushanara Ali:** Are you aware of anyone in the Bank suggesting it?

Sir Jon Cunliffe: I am not. No, absolutely not.

Andrew Bailey: I checked, because I knew you asked this question about whether David Cameron mentioned it in a meeting with the Bank. I checked with the staff who were in the meeting. That never came up.

Q161 **Rushanara Ali:** Thank you for clearing that up. That is really, really helpful.

This is linked to the point about the Treasury. Earlier on, Sir Jon was talking about the Treasury asking the Bank of England whether it could look at proposals to support Greensill. Given everything else that is going on, this is one of the things we are trying to understand. Greensill was a bit like a hot potato that people kept passing on from one place to another. It landed with the British Business Bank, and ultimately it did secure £400 million.

As you know, I have been asking questions about this. Given Wyelands

Bank and all of the things we have just talked about, given the SFO and the FCA—when you were there, Governor—dealing with some elements of this, how did this hot potato end up in the hands of the British Business Bank? How on earth did taxpayers' money end up being released after all this? I just wanted both of your reflections on that. Ultimately, the substance of this situation is that taxpayers' money ended up in the hands of—

Andrew Bailey: I have to be honest with you. The Chancellor has set out the situation on the British Business Bank both in his letter to the Committee and, indeed, in the letter he wrote to the then Shadow Chancellor, which set this out in some detail.

Q162 **Rushanara Ali:** The answers were not very—

Andrew Bailey: You will have a chance to ask that question later on in the week. It is honestly better asked then than today.

We have no gateway under statute either to the British Business Bank or to BEIS. We have no gateway to provide information. As I said earlier, we kept the Treasury fully informed, but we have no gateway to the British Business Bank or to BEIS.

Q163 **Rushanara Ali:** Sir Jon, you were talking about the fact that you did not feel particularly under pressure to come up with something to satisfy the Treasury, given the intensity of the lobbying. Greensill's footprint seems to be around the system a fair bit. Did either of you come across Mr Greensill in the past in any capacity?

Andrew Bailey: I can honestly say that I have never met Mr Greensill. I have never exchanged emails with him or any other form of communication at all.

To the implication that the Treasury was putting the Bank of England under pressure to do something, Jon will speak for himself, but I never felt under any pressure from the Treasury. We were operating as the agent for the CCFF. We were doing that job and we were working very closely with the Treasury. It was a very successful operation. There was never any pressure on us, not at all.

Sir Jon Cunliffe: I will maybe just answer a couple of questions. First of all, it did not feel to me—I do not know what happened with the British Business Bank—like a hot potato at all. They came in with a proposal; it did not meet the rules; we told them very quickly, "It does not meet the rules". They then said, "Can you change the rules?" or whatever, and we said, "No, we cannot change the rules. Talk to the Treasury, if you want". I have said that to others.

They came back with something and said, "Does it meet the rules?" and it did not take very long to say, "No, it does not meet the rules". It did not feel like it was a big thing. The call for evidence on the general question—

Q164 **Rushanara Ali:** I cannot imagine someone being able to push you or the Governor around and put you under pressure. You are seasoned operators in this territory.

I want to come to this point about the Treasury making an announcement. There has been a month and a half of activity over March. On 19 March you then had the Treasury announcing the coronavirus business interruption loan scheme, which is a scheme that Greensill Bank did succeed in accessing. You will appreciate that, although you went back robustly to the Treasury, the Treasury did come up with a plan that was successful in terms of Mr Greensill and co being able to access funds through the British Business Bank.

Andrew Bailey: The context to put that into is that we were all working very hard at that stage to ensure that financing was available to British business. It was not about Mr Greensill; this was about British business. We were in an unprecedented and pretty desperate sort of situation at that point. There was a lot of activity to say, "How do we get financing out to those who need it?"

In a sense, the sense of what was going on behind us was also, "Are we leaving any important gaps in the coverage of these schemes that we will regret in terms of the impact on the economy?" A lot of the work we were doing with the Treasury was saying, "Have we got the bases covered?"

Q165 **Rushanara Ali:** Can I come on to the wider issues? You talked about the regulatory perimeter, Governor, and how this particular case would not have amounted to systemic failure. We have seen signs of securitisation-type stuff going on. What would it have taken? How big would a Greensill-type case, or multiple cases, have to be to mean a systemic failure? With these sorts of cases, because they do not fall within the regulatory perimeter, the taxpayer ends up suffering but the regulators cannot act and the system does not kick in to protect people. If you like, the early warning systems do not really go far enough to deal with potential future systemic failures. What are your reflections on that?

Andrew Bailey: The test for systemic failure that I would apply from a financial stability point of view is twofold. First, there is the effect on the real economy. Was Greensill's activity of sufficient scale or nature that it was affecting the real economy? It might be big or it might be specialist in particular niches. The answer there is no.

Q166 **Rushanara Ali:** Apologies, Governor, but I did not necessarily mean the specific case. How big would something like that have to be?

Andrew Bailey: I was trying to generalise. The first test is the effect on the real economy: the scale of that activity and that business in terms of its impact on the real economy. The second test is the interconnectivity in the financial system. Is it some piece of the financial system that is so interconnected and therefore likely to cause damage to other parts of the financial system? Is the systemic impact something we could not allow to happen without being concerned about the damage? As I say, it did not pass either of those tests.

Q167 **Rushanara Ali:** Finally, on insurance, Mr Greensill talked about the insurance provider letting him down and letting the company down. What are the lessons around accounting and insurance out of this case, would you say?

Andrew Bailey: It is an Australian insurance company. I know that he has suggested in his evidence to you that there is some problem with insurance regulation, that it is procyclical and that it tightens at times like this. Australian regulation is not that different to ours. It has a certain amount of procyclicality, but that is not the reason he got into the problem.

There are two reasons he got into the problem. One is that, as I understand it, that Australian insurer was exceeding its underwriting limits to him. That was an internal control failure. They realised it and pulled the limit back; they cut the limit. Secondly, his business model was excessively dependent on insurance. The problem is that he could not sell his paper, his notes, in the absence of insurance cover. Once the insurance cover fell away, he went from everything to nothing. That is a vulnerability in his business model that he should have thought about.

Q168 **Rushanara Ali:** Is that sort of business model deeply problematic? As we have heard, some people have defined it as showing the hallmarks of a Ponzi scheme. Should we be looking out for things like that?

Andrew Bailey: It is not a Ponzi scheme. I have to say that Paul Myners uses the words "Ponzi scheme" rather liberally, because it is not in the traditions of Monsieur Ponzi or Senor Ponzi—whatever he was. A Ponzi scheme is a different animal. It probably had more than one structural weakness in it, but one of them was this excessive reliance on insurance cover.

Q169 **Rushanara Ali:** There are people who say—you said it today—that supply chain finance does not need regulation. I hear what you are saying, but this particular case, where supply chain finance has been distorted—perhaps you will come up with a better phrase than I can think of—has led to a problem that is going to cost taxpayers money. This is a question for either of you, really. What are your reflections on where we go from here to avoid this sort of thing happening in the future? You can reflect on your FCA days as well.

Andrew Bailey: Let me offer you one reflection. I am going to be careful here, because I will come across as a luddite and I do not mean to be a luddite at all. Innovation is a good thing, but we all have to be very clear-eyed about innovation. It is easy to get carried away with financial innovation. I am afraid that I have seen it.

Honestly, some of the rather painful discussions we have had in this Committee in the past have had this theme to them. There is an awful lot of enthusiasm for innovation, and it is a good thing. I do not want to be labelled as the person who is against innovation at all; it is a good thing. But there is a danger that we get carried away. It is why I am sceptical about crypto-assets, frankly, because they are dangerous and there is a huge enthusiasm out there.

Q170 **Rushanara Ali:** You both presided over the financial crisis. You survived that and helped us get through that. There are people who have gone off to do so-called innovation, but actually it is not innovation. They are coming up with new schemes that are going to wreak havoc, even if they do not fall into the regulatory perimeter. We should be looking for this stuff that could become a big problem.

Andrew Bailey: In a way, it is ever present. If you draw a line around something and say, "It is regulated inside", there will always be people trying to do it outside. Jon has massive experience as well, and he will have views on this.

Sir Jon Cunliffe: What one sees happening repeatedly is that there is a good and sensible idea. Securitisation of mortgages is a useful way of allowing insurance companies and others to have exposure to mortgages. People use it sensibly, but then people take it too far or it gets abused. Supply chain financing with a fintech that enables SMEs to get their money into their bank accounts earlier without huge hassle and perhaps paying lower charges is a good thing, but, like all things, it is not the thing itself; it is the motivation and what you try to do with it. There are many reasons to regulate, not just financial stability: There is consumer protection; there is investor protection. Greensill is regulated for money laundering and AML. Financial stability is not the only game in town, if people are worried about risk.

My own view on this is that in the end—the Governor mentioned this—it is to do in part with the auditors. The auditors have to say why a company is using supply chain financing, what the motivation is and whether it is trying to disguise its real indebtedness or whether it is using it for another purpose. You often see sensible ideas turn into subprime.

Q171 **Dame Angela Eagle:** I want to come back to some of Sir Jon's comments in a minute, but, first, Sir Jon, were you surprised by the ferocity of David Cameron's lobbying or were you completely sheltered from it because you are the independent Bank of England?

Sir Jon Cunliffe: I did not get much ferocity, to be honest. I had a phone call and two emails.

Q172 **Dame Angela Eagle:** You were not aware of what was going on elsewhere.

Sir Jon Cunliffe: I knew he had had discussions—

Q173 **Dame Angela Eagle:** Mr Roxburgh and others did not phone you up and say, "For god's sake, get him off our back".

Sir Jon Cunliffe: No, but I knew that Charles Roxburgh was having conversations with him. A lot of companies were having conversations with the Treasury, and with us, actually. When all of that came out, I was not aware of how many meetings and discussions there had been. It did not feel particularly ferocious at my end, anyway.

Q174 **Dame Angela Eagle:** Is there perhaps some benefit in future to all sections of the Government and the Bank of England knowing what these contacts have been so that you can see whether ferocity has applied or not?

Sir Jon Cunliffe: I would maybe go back—this kind of answers the question—to something that David Cameron said, which is his point or his realisation that it would have been better to have written a formal letter, because people knew he was working for Greensill, to put it on the record, rather than using WhatsApp. I only got official emails. That would be better. It would be better if that was done formally and clearly, yes.

Q175 **Dame Angela Eagle:** Again, learning the lessons from this, if you are asked to make a decision about something, it is helpful to know whether 10 Ministers and goodness knows how many other WhatsApp messages et cetera have been sent to everybody's phones. There is something that is frantic in the nature of what happened here. It is almost like Greensill knew it was in trouble and was trying to access funds. Surely that is an added bit of information, Sir Jon, that you would want. I know you are completely objective. I always thought that when I worked with you. Surely there is information here that you were not aware of, which has come out because of the investigations the press have done, that sheds a different light on things.

Sir Jon Cunliffe: I knew the Treasury was talking to him. When I got the email—it was the first one—from David Cameron saying that they had talked to the Treasury and what was happening, I rang up the Treasury. In my response, I said, "I have spoken to the Treasury. I understand that you have spoken to the Chancellor". It helps a bit, but in the end knowing that this is happening gives you—

Q176 **Dame Angela Eagle:** He is an ex-Prime Minister. He is not just somebody's mate.

Sir Jon Cunliffe: No.

Dame Angela Eagle: I am sure he has lots of mates, but you know what I am saying.

Sir Jon Cunliffe: In the end, the most important thing is what you do with the thing you get, if I can put it that way. You know that there is a lot of lobbying of Ministers. There is always a political atmosphere around lots of things, if I can put it that way, with people lobbying, not necessarily about commercial things. It is useful to know that, but the most important thing is still that you look at the issue on its own merits.

Where it is your responsibility, you take it; where it is not, you say, "You are going to have to go somewhere else".

Q177 **Dame Angela Eagle:** Governor Bailey, are you surprised that Gupta was given a banking licence? Why was he given a banking licence? He obviously applied for it, but how reasonable are our rules at the moment on who should get a banking licence?

Andrew Bailey: I was not involved in it myself, but he acquired it through a change of control at the end of 2016. He met the terms for authorisation. In the lessons learned from all of this, we will go back and look at it. There have been some changes in the rules around acquisitions over recent years that have some relevance to this, but it is something we will go back to, certainly.

It would be, I am afraid, applying great hindsight from today to go back to 2016 and say, "Obviously, you could have told these things about Gupta at that point". I do not think anybody—

Q178 **Dame Angela Eagle:** I am not making that argument; I am wondering whether our controls are robust enough.

Andrew Bailey: That is one of the issues that we will look at in the wake of this. We will certainly look at the acquisitions regulations, because collectively we now have more scope—you are part of this at the moment as well—to influence those, because they were EU regulations. We will certainly do that.

Q179 **Dame Angela Eagle:** Sir Jon, are you worried about how supply chain finance has evolved in the hands of Lex Greensill? It is a bit like your move from perfectly respectable to subprime. Are there lessons that we need to learn about that in terms of trying to keep a handle on what is going on?

Sir Jon Cunliffe: There are a number of investigations going on. As I say, I do not know what happened within the Greensill Group. The Greensill Bank is in Germany. I am not sure. I had a look at the administration documents. It looks as if the failure of Greensill was to do with the fact that Credit Suisse pulled the plug on the £140 million loan.

What was underneath that? As I say, it is not regulated; I do not know. We will have to wait and see what comes out of the various investigations that have been mounted. Within the supply chain finance model—I do not see the model itself as being the problem—were there particular features of Greensill and things Greensill was doing that made this a bad operation? We will have to wait and see on that. For the moment, I just see the model. A number of banks operate it. Greensill is not the only one doing supply chain finance. I would have to see what is revealed about what was happening inside the box, if I can put it that way.

Q180 **Dame Angela Eagle:** There is an issue with securitisation, though, is there not, in an unregulated space? The 2009 global financial crisis was caused by banks doing things. This seems to me very similar but done in the shadow banking space. Is it not something that we should be worried about, if we have regulated banks so tightly that all of this stuff is now spilling out in an unregulated space?

Sir Jon Cunliffe: I very much agree that there is an issue with what we call non-bank finance, market finance, which has grown enormously over the last 10 years. It poses risks. They are not the same risks as banking. They go much broader than supply chain finance, but we saw in that episode in March, the so-called dash for cash, that there are real vulnerabilities that we need to explore, in order to work out what happened and why.

On securitisation, there is regulation. There is the securitisation regulation and the like. In this case, as far as I know, it was not structured finance, which is the subprime thing. This was just straightforward commercial paper. There were no senior tranches and junior tranches. It fell outside of that regulation.

Q181 **Dame Angela Eagle:** There are certainly indications of circular finance; there are indications of quite a symbiotic relationship between Gupta's GFG and Greensill itself, all of which is fine if you have very robust and proactive anti-fraud activity going on. We seem to be in a situation now where everything has to collapse after the intermediaries who have caused this have got very rich and fled the scene, leaving everybody else to clear up the mess. That is not a way to ensure that our markets are healthy, is it?

Sir Jon Cunliffe: Some of this comes to investor protection. What do the investors know? What was said? What did the people who bought the Credit Suisse funds know? What was said about the finance that they were buying? If there was circular financing, did they know whether the invoices were fraudulent? I do not know whether there was fraud or not. We will have to wait and see. Some of this is to do with, on the company side, the auditors and the advice that has gone out to auditors. The accounts have to be very clear on what the company is using supply chain financing for, what the motivation is and to what extent it would change your view of the company's indebtedness.

On the more general question of whether the activity of commercial lending, or one form of it, be regulated, I know it has been looked at a number of times in policy terms. You can make a case for it and against it, but it is a high hurdle to bring commercial lending into the regulatory perimeter. There may well be investor protection and other areas.

Q182 **Dame Angela Eagle:** Governor, you seemed to have something that you wanted to say about that. I am interested in not only systemic issues—and you have dealt with that—but investor protections. If you can somehow be good enough to build something up, extract a lot of funds and profit out of it yourself and then run off with your ill-gotten gains as it collapses, leaving the losses with everybody else, that does not seem to be a reasonable sort of market for us to allow to exist unscathed, does it?

Andrew Bailey: No. The other question is that these instruments could not be sold to retail investors. If they had tried to sell them to retail investors, much tighter regulation would have hit them. The consequence was that they were sold, if you take the Credit Suisse case, to wealth management clients, the high net worth end of the market. The underlying issue that you pose is, "Where do you want to draw the boundary on regulation in terms of protecting investors?" As you rightly say, we have to look at the consequences in terms of the fallout for wider financial market disruption. As I said earlier, on the financial stability question, we do not judge that to be systemic.

Again, there is this old question about the distinction between wholesale on one side with wealth management and retail on one side. Where do you draw the lines in regulation? Historically, it has always been viewed that you put tighter regulation in for retail than you do for wholesale. The question comes up regularly. It is still the right thing to do to have different regimes for wholesale and retail, but you pose a good question as to what those regimes should be.

Q183 **Dame Angela Eagle:** Finally, perhaps the other way of dealing with this would be to have much more robust criminal preventive activity among the policing elements of the system, because it does not seem to me that this ever gets stopped in its tracks before the people perpetrating it have got very rich very quickly. Therefore, the risks they run are quite low, and the rewards are—

Andrew Bailey: To be honest with you, we have talked a number of times in hearings about the fraud capacity question. Let me be clear: as I said in the context of Wyelands, the Bank of England provided the evidence to the SFO and the SFO came in, in this case, very promptly. That is very good.

You pose the broader question, which we have discussed before. You have been doing an inquiry on this as well. There was a very critical report by the inspectorate of constabulary a few years ago on this question about what the capacity is in this country these days on that front. I have to say that it is not good enough.

One of my concerns—we have discussed this before—at the FCA was that, for want of law enforcement fraud-fighting capacity, the regulator would be brought increasingly into it. Frankly, it would jeopardise the ability of the regulator to do the job it is supposed to do.

Dame Angela Eagle: Thank you.

Q184 **Harriett Baldwin:** I am going to change the subject slightly and start talking about monetary policy. I wanted to read to you, Governor, some of the things that have just been in the papers over the last week. Prices are rocketing at the fastest pace in 21 years in the UK. There is apparently a drought of staff. The housing market is reported to be red hot. Retail sales are 10% above pre-pandemic levels. The price of timber is up 93% since January 2020. The price of steel is up 14%, year to date. Guttering is up 16%, year to date. The prices of windows and doors are up 6% to 12%. Tile roof battens are up 105% and plasterboard up 4%, year to date. Why are you doing another £50 billion of quantitative easing?

Andrew Bailey: The official rate of inflation that we target rose in April from 0.7% to 1.5%. That is still below the target. We have been expecting this increase since last summer, because a lot of it is based on what we tend to call annual base effects, particularly to do with energy prices, as there is a very big swing around them. The forecast we published in the *Monetary Policy Report* earlier this month suggests that inflation, with more of these base effects to come, will rise to target and probably through target to around 2.5% later this year, but we then think it will come back down. That is a combination of a few things going on. One is these base effects. On their own, base effects come and go because they are annual effects. They are not sustained effects; they are about movement in individual prices.

Secondly, as you say—and we hear this from our regional agents; I spent a day virtually in Wales, a week or so ago, and heard very similar stories to the ones you have just been telling—there are some very hot spots and hot areas of prices. There is no doubt about that. They reflect a number of things. They reflect some global effects. Global commodity prices have increased. We have a world shortage of semiconductor chips. We have had disruptions to trade. Those things are going on. At the moment, because of Covid, we unsurprisingly have quite an unbalanced recovery. Demand in goods markets is much stronger than demand in services at the moment. That is already beginning to correct and we are all hoping to see it correct substantially as the services economy reopens, but we have had that imbalance. Some areas of goods prices and goods demand have been very hot during this period, as people have been able to spend on them.

The last point I will make on this is that one of the very difficult things to estimate at the moment is the supply and demand balance, the output gap, if you like, or the amount of slack in the economy. Normally in a recession demand falls much more and supply does not fall that much. Here, of course, both moved heavily, because of the well-known effects of lockdown. We think there is an output gap, but it is quite difficult to estimate it. Also, individual parts of the economy are going to move around quite differently as the economy comes out of the restrictions. We will get shortages in some areas and not in other areas.

We therefore have what I call this hump in the forecast. We talk about the hump a lot in the MPC, in the best sense of using that term. We have inflation going up and coming down again. As I said last week, we have to watch this very carefully, because clearly we have not seen any sign that inflation expectations are rising in a concerning way, but if we start to see that, or if we start to see these price increases becoming embedded, that is a cause of concern. At the moment that is not our central view. At the moment we think that doing the remainder of the £150 billion, which is consistent with the setting of monetary policy, is appropriate.

Q185 **Harriett Baldwin:** Andy, you were a dissenting voice in the last meeting. You are leaving the Bank. I wonder if you are as sanguine as the Governor sounds.

Andy Haldane: The two events are not related, by the way. My assessment does not differ hugely from Andrew's. It is clear that, if you speak to businesses across the UK right now, that among their top three issues is this pipeline of very significant cost pressures. You mentioned a whole list of things that were going up, and going up at real pace. It is hard to find goods or assets that are not going up right now, with the dishonourable exception of bitcoin.

The real question for us as policymakers is whether those costs will be passed through to the consumer. It is there in the input price for businesses. You see that very clearly. It is starting to show its face in the output prices, the wholesale prices businesses charge each other; it is there. The question is how much of this will ultimately show up in the consumer prices, the CPI that is our target. We expect some pass-through of those cost pressures later in the year. That is one of the most important reasons why we foresee inflation picking up, first to around its target in the late summer and then a little bit above target by the end of the year.

The question then becomes whether those price rises will stick around and whether those cost pressures flow through to consumer prices on a more persistent basis. It is on that particular point that I probably have a somewhat different view than some others on the committee. I think there is a better than evens chance that companies will take advantage of what will then be a pretty strong economy, an economy running at above its pre-Covid levels of activity. They will use that opportunity to recover their margins and to put prices up. That may then flow through to the wages that workers demand as headline inflation pressures pick up, and therefore inflation itself proves rather more persistent.

Of course, there is no certainty about anything I have just said. It is a judgment based upon my sense of how big the pipeline of cost pressures is and how much will flow through to consumer prices. My judgment would be that there is a risk of that proving more persistent, which is why I voted to truncate the expansion of our QE programme at £100 billion. That would still leave the stance extremely accommodative by any historical metric, but my sense was that the balance of inflation risks had tilted to the upside and, therefore, justified reducing that degree of accommodation by about £50 billion.

Q186 **Harriett Baldwin:** Michael, as the external member that we have today, do you feel as sanguine? At the end of the day, this is going to increase the cost of living for people in this country. How can you justify failing to act on it and keeping a foot to the floor in the way that you are doing?

Michael Saunders: The big picture now is that the economy is recovering, but it is recovering from a low base. The level of GDP in the first quarter was between 8% and 9% down from Q4 2019. That is a much steeper drop in GDP than we have seen in any recession over recent decades, much steeper than what we saw in 2008 to 2009. A drop of GDP of that scale, if it were to persist, would cause a sharp rise in unemployment once the furlough scheme comes to an end.

The economy is now recovering, which is really good news. We need it to recover promptly in order to prevent a sizeable rise in unemployment and persistent below-target inflation. I do not yet see evidence that the economy is recovering strongly enough to move into sustained excess demand. At the moment, the recovery we are on is just getting back to normal. I would not call that a boom; we are moving out of a position that, if sustained, would lead to a large and persistent rise in unemployment and below-target inflation.

Q187 **Harriett Baldwin:** Are you confident, in terms of our constituents and the costs of living that they are going to experience, that the risks are fairly evenly spread around the central scenario in terms of inflation? I am not an expert, but it seems as though they are very, very skewed to the upside from here.

Michael Saunders: It is likely that the swings in energy prices, if the recent pick-up in oil prices is sustained, will produce a temporary period of above-target inflation. That is the mirror image of the very low inflation figures we had when oil prices fell sharply during the pandemic, but unless oil prices go on rising that effect should be temporary. I do not see evidence that we are set for a sustained period of above-target inflation, but we have the tools and ability to ensure that inflation goes back to the 2% target on a sustained basis. The one thing that your constituents should not be in doubt of is our commitment to achieve the 2% inflation target over time.

Q188 **Harriett Baldwin:** How painful could that be in terms of rate rises and the speed of rate rises, if you are seeing a sharp and sustained uptick in inflation?

Michael Saunders: The central forecast in the *Monetary Policy Report* that we published a couple of weeks ago was conditioned on market pricing for interest rates. That included a rise of 50 basis points—half a percentage point—in bank rate over the next three years, very much towards the second half of that period. That forecast, which is reasonable, would leave inflation very close to the 2% target two and three years out. The implication of that to me is that the yield curve is in a reasonable place. If events come out more or less in line with the May

MPR forecast, down the road we might need some modest monetary policy tightening, but not yet, and the word is "modest". There are quite a lot of conditions to get through before we see that. Remember, while the economy is recovering, it is still not operating at a normal level. It is still some way short of that.

Q189 **Chair:** Michael, when you say that modest monetary tightening might be necessary, what does "modest" mean in that context?

Michael Saunders: I am just referring to what was priced into the market yield curve, which was the conditioning forecast for the May *Monetary Policy Report*. That forecast was conditioned on a yield curve that included a 50 basis point—half a percentage point—rise in bank rate over the next three years, with that rise in bank rate occurring in the second half of the forecast period. I was describing that as a modest tightening.

Q190 **Felicity Buchan:** Good afternoon, everyone. My section is on what we should be most concerned about—economic scarring or inflation. From some of your remarks, we have a good idea of the answer to that. Let me start by defining economic scarring. I see that, in your forecast, you have changed your forecast to 1.25% of GDP for economic scarring, down from 1.75%. That is a lot more optimistic than the OBR, which is at 3%, and the IMF. Andrew, why do you feel so confident in reducing the scarring forecast when you are already at the optimistic end of the range?

Andrew Bailey: That is a good question. A good part of this is conditioned on the change in Government fiscal policy. When we did the February *Monetary Policy Report* forecast, it was conditioned on fiscal policy at that time, which was pre-Budget. One of the important changes in the Budget was to extend the furlough schemes beyond the point at which we expect the economy to be reopened with the lifting of Covid-related restrictions. The furlough schemes now extend through to the early autumn, though there is obviously some run-off in their terms. That is an important change, because it means that the schemes are operating until much further into the recovery of the economy, as Michael was saying. What we are seeing this year is a very high percentage growth rate that is forecast for the economy, but in fact it is the bounce back, if you like. By the end of the year, it is taking us back to where we were at the end of 2019. The furlough schemes now run through much further into that bounce back and recovery.

That is relevant to scarring because we reduced the unemployment profile in the forecast very substantially, from somewhat over 7.5% to just under 5.5%. That is a very substantial change; in fact, in one quarter that is a huge change. The consequence of that is that we think there will be less long-term unemployment. In other words, more people will move from furloughed back into job rather than from furloughed to unemployment to job.

Secondly, within that mix of the labour market, which is quite complex at the moment, we are seeing quite a big rise in inactivity—in other words, people who do not have jobs and are not searching for jobs. We would expect some of that to turn around as well, as people start searching for jobs. More people will move back into the labour market and more people will move back into jobs. That will reduce long-term unemployment. Long-term unemployment is a major contributor to scarring because, as we know from history, more structural unemployment tends to cause people to be out of the labour force for longer and to cause larger losses on a more long-term basis to activity, to GDP.

The other thing that I will repeat, which I think we have discussed at previous hearings, is that, in my view, this recovery will also involve less capital scrapping, in the sense that there will be less redundant capital, though there will be some because we will find that we will not go back to exactly what we were doing before Covid and there will be some areas that will have that effect. On the whole, there will be less, which is why we have always been at the lower end of the scarring assumptions for the last year. It is this change in the labour market outlook that is important in judging scarring.

Michael Saunders: This question of scarring is very important. First, whether scarring turns out to be 1.25% or 3%, as the OBR expects, in either case the level of scarring will be much lower than we saw after the recession of 2008 to 2009, when scarring was 10%, perhaps more, of GDP. A key reason for that has been the greater resilience of the financial system, which has ensured the continued flow of credit, especially to small firms. That has helped to underpin investment and employment, and behind that is the prompt and large scale of fiscal support, monetary policy easing and credit easing. All of that has helped to keep firms going and people in work.

Secondly, in terms of the difference between our estimate and the OBR's—and the difference is relatively mild compared to the difference between both of those forecasts and the experience after the GFC—a part of it is that there have been some more figures for investment published after the OBR made its estimate. They showed upward revisions to investment spending during last year, so we have a smaller adverse effect on potential output from weakness in the capital stock and total factor productivity. We also have slightly different judgments over whether some of the people who have drifted out of the workforce into inactivity, as Andrew said, will come back. Our expectation is that they will come back; the OBR takes a different view. There are also uncertainties over migration flows. Quite a lot of these things are uncertain and we will learn more over time, but in either case, big picture, scarring will be much smaller than after 2008 to 2009.

Q191 **Felicity Buchan:** Andrew, you mentioned that you have made a pretty dramatic change to the forecast for unemployment. You are now forecasting a peak of just under 5.5%. What is your confidence level in that forecast? Are you concerned about hidden unemployment, such as people who are working but on fewer hours?

Chair: Before we answer that, Jon wanted to come in very quickly on the last question.

Sir Jon Cunliffe: This is not in our scarring forecast, but it is quite interesting that we managed to go through this forced experiment in shutting large parts of the economy down and working from home. Productivity did not suffer as much as people would have thought. There is an upside in some of this experience that we have had: we have learned that we have capability and capital sitting in our phones and on our desktops, which enables us to work much more flexibly. While there may well be scarring from having to move people and capital between different sectors of the economy, there is an upside, in that we have discovered the frontier of the capital stock we have, including the capital we all have at home. That may be an upside that goes the other way.

Andrew Bailey: Coming to your question, we have discussed this in previous hearings. The labour market has been hard to read over the last year or so. There are a number of things going on. The furlough scheme has obviously had a big effect, and this trend in inactivity, which Michael and I both mentioned, has had an effect. There is no criticism whatsoever of the ONS. It is quite hard to collect the data at the moment because they do have to do interviews to determine some of these things, particularly like inactivity and unemployment.

However, the supporting data, of which there is a lot, both surveys and numbers, is increasingly strong. Looking at job vacancies and the employment numbers suggests that that corner has been turned, as it were. While employment did fall much more than unemployment rose, of which the inactivity story is part, that corner has now been turned. As I was saying earlier, I do a virtual regional visit every month and I have noticed this year that there has been a gradually strengthening story in what I have heard on my visits with the agents. This culminated in the one I did in Wales a couple of weeks ago, when it was undoubtedly a very strong story, quite universally. The story on hiring is turning round. There is every reason to be reasonably confident about the labour market. I do not want to be accused of banging a drum, but if we can achieve what is in the forecast, in terms of unemployment, that is a very substantial achievement, given what we have been through in the last year or so.

Q192 **Felicity Buchan:** Yes, agreed. Let me go back to my original question, and I will come to you each in turn. I am conscious I do not have much time left, so perhaps we could have quite pithy answers. What are you most concerned about? Is it economic scarring, the effect of the pandemic, or inflation?

Andrew Bailey: We have to watch inflation very carefully now. I do not want to be dismissive in any sense of the points that Harriett Baldwin was making, because she is hearing exactly the same things that we hear. We have to watch it very carefully, but I hope we have conveyed between us that we see this as a story of an economy that is still recovering, as Michael quite rightly said. On the cost of living implications for people, inflation is still under target at the moment.

Q193 **Felicity Buchan:** Are you concerned about the effects of fiscal consolidation in a couple of years' time?

Andrew Bailey: That is part of the story about the hump, if you like. There is another hump in there, which is growth. It is obviously for the Government to choose the fiscal path. I am not going to comment on that, but the second set of issues that emerge in the second half of the forecast are much longer term, which are what we need to do to raise the trend and underlying rate of growth in this country. It was very low for a decade or more from the global financial crisis to the Covid crisis. There is no question that we will find it easier to deal with the issues that we are going to inherit from the Covid crisis, including debt, for both business and Government, if we have a higher rate of growth in the economy. That comes back to productivity and investment in good part.

Q194 **Felicity Buchan:** Andy, what are you most concerned about? You have obviously said that inflation risks are tilting to the upside, but is it scarring or is it inflation?

Andy Haldane: In the early stage of the crisis, our sights were rightly focused on stimulating the economy, largely with an eye to mitigating the degree of scarring. In terms of the actions we took between March and November last year, all the stimulus we provided was very much with a view to supporting demand and avoiding those long-term hits to the supply side of the economy.

As we have moved through with the vaccines coming on stream and the economy now recovering at real pace, the balance of those risks has shifted. The focus should therefore be squarely on our primary objective as an inflation-targeting central bank, which is inflation. That is a combination of an economy rapidly bouncing back with a very significant amount of financial fuel in the tank by dint of the savings accumulated during the Covid crisis, which means it is plausible—likely, I would say—that the economy will be flying somewhat above potential for a protracted period. For me, that alters the balance of risks on the inflation side to the upside.

Of course, of all the things we want to avoid right now, an upside surprise to inflation is among the greatest, because that would come at the cost of us needing to tighten policy even more rapidly or on a more significant scale, or possibly both, in a way that would then take the legs out of the recovery that we all hope we will get. That is the reason why I see the balance of risks, as things stand, being more on the side of inflation rather than scarring.

Sir Jon Cunliffe: I will try to be pithy. On the one hand, you have inflation. We expect inflation to rise. There will be bottlenecks. We are going to see fast rates of growth, because we are coming from a very low place. The risk is whether it gets embedded in inflation expectations and into the prices chain.[2] On the other side—it is two-sided—we do not know how people will respond and whether they will continue social distancing even after they have been vaccinated. We are not sure what will happen when the CJRS comes to an end in terms of unemployment or corporate insolvencies. We do not know whether recessionary dynamics and precautionary saving might set in after this burst of immediate spending.

They are two-sided risks. Risk management is important. You can get trapped near the effective lower bound, so you have to think about what instruments you have to deal with the downside versus what instruments you have to deal with the upside. To my mind, risk management still gives you some view on where the balance of risks lies and what action you should take.

Q195 **Mr Baker:** I refer to my registered shareholding in Glint Pay, and it also seems appropriate to say I am a fellow of the RSA, so I am delighted to welcome our new chief executive. Welcome, Andy. I would not be surprised if some rules changed soon. I am delighted to be a fellow and delighted to welcome you.

I want to turn to the conditions under which QE might start to taper. In paragraph 58 of the minutes, you issue some forward guidance. You say that you do not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably. What specific triggers will you be looking for on those points, and how long before you will know one way or the other that you are making progress to meet that guidance?

Andrew Bailey: It is a great question. Just to draw out some of the points we have already covered but put them into this specific context, if we turn to inflation, I mentioned earlier that we are seeing a somewhat mixed pattern at the moment, with some prices rising rapidly and some not. Those rises often reflect the goods/services imbalance we have had in the economy during the pandemic, some global shortages and some particular supply contentions. There is this question about how we adjust supply and demand back into balance. If we were to see signs that that pricing pressure was becoming more generalised, it would be a signal that would cause us to have to evaluate where we were into the guidance and at what point the guidance has to fall away.

In the spirit of what Andy was just saying, that is an important test of it, which is why we are going to have to look at what I might call the entrails of the inflation evidence very carefully from now onwards. It is not that we do not always look at it carefully, but we will look at it even more

[2] The word "prices" has been added at the request of the Bank.

carefully going forwards. The growth story is also relevant there. In many ways, there is this very difficult conundrum we are working with at the moment about how we judge the output gap in what is a very unusual situation and economy, given what has happened in the last year or so. We had a fall in both aggregate supply and aggregate demand.

Q196 **Mr Baker:** I am so sorry to interrupt. Could I pick you up on a particular point there that is very closely related to what you are saying? It seems to me that the data you rely on is somewhat disrupted by the pandemic and possibly in a misleading state. To what extent are you concerned about the Bank's ability to get at the data that it needs, thanks to the pandemic?

Andrew Bailey: Coming back to monetary policy after quite a break, one thing that has really impressed me is the huge expansion in the range of data we have in our hands. A lot of that reflects the access to digital data and online data, so that our close read of what is going on in real time is much better. That helps us only to a point because, as my colleagues have been saying, we have to forecast two or three years into the future. We have got better at telling you what will happen in the next quarter; it starts to run out, but it is invaluable for judging what is going on. In the last year or so, I have been enormously impressed by the huge increase in both the amount of data available and how the Bank uses it.

Q197 **Mr Baker:** Sir Jon, what are you personally going to be looking for in order to know that that forward guidance has begun to be met or is perhaps being met?

Sir Jon Cunliffe: I will be brief because I mentioned some of it in my previous answer. I will be looking to see how people behave once they have been vaccinated, once restrictions are lifted, and whether we are going to see voluntary distancing and voluntary changes in consumption patterns and investment. I am looking to see what happens at the end of CJRS. Are people absorbed back into the labour force? I will be looking to see what happens to corporates and what level of insolvencies we see, because that will feed into unemployment, as well as this question of whether you get any recessionary dynamics with people starting to do precautionary saving.

I am very interested to see what happens in the housing market, and how much of what we are seeing now is due to the stamp duty holiday and how much is due to underlying strength in the market. I am also interested in health outcomes—because there are mutant strains out there—and the possibility that either the fear of them or the actuality of them will push us into a lower pattern of growth. We are expecting a bounce, and it looks as if it is going to be a vigorous bounce. The question is what happens on the other side, and, as a result of that, whether inflation expectations and cost pressures get embedded in the system. Those are the things I will look to.

Q198 **Mr Baker:** Can I pick you up on that one point? I had better refer to the declarations I have made as deputy chair of the Covid Recovery Group. On this point about how people adjust their behaviour, you drew a distinction just then between health outcomes and people's perceptions of health outcomes. Could you tell us a little more about the importance of that difference?

Sir Jon Cunliffe: As far as people's consumption decisions are concerned, it is their perception of risk that matters. As far as Government policy is concerned, the point at which the Government has to introduce restrictions, that is driven more by health outcomes and the best prediction you can make of your central case on where infections and hospitalisations are going. People might not react in the same way as policymakers when it comes to their behaviours. We have not had a pandemic for over 100 years and society is very different now. There is a lot of uncertainty.

Q199 **Mr Baker:** The point I am driving at is that people's perception of risk is very highly dependent on what the Government say to people. This has been the subject of considerable public debate recently. The Government choose the messages that they put out there, particularly in relation to variants, and that could have a very material effect on the way that people behave.

Sir Jon Cunliffe: People listen to the messages they get from authority, institutions and experts. That then affects their judgment. In today's world when individuals have access to the internet and a huge range of things, their fears and hopes are formed by many things, and there is very often confirmation bias, in that people find the evidence of the thing that supports their fear or expectation.

Q200 **Mr Baker:** May we be protected from confirmation bias.

Mr Saunders, can I put to you something the Fed said? In your earlier evidence, you used the phrase "mirror image" and talked about meeting the target over time. I understand that at the Jackson Hole summit the chair of the Fed said that they would target inflation of 2% averaged over time. Is that something that you were referring to or implying when you made your remarks?

Michael Saunders: Absolutely not, and I apologise if my language was unclear. The Fed is doing average inflation targeting. We are not. Our remit is to aim for 2% inflation. There are some factors that will produce a temporary, transitory period of above-target inflation in our forecast. That is just to do with this swing in energy prices. It is not that we are aiming for above-target inflation, but we do not respond as closely to factors that are temporary. You would not expect us to.

Q201 **Mr Baker:** Andy, earlier you used the phrase that monetary policy would remain "extremely accommodative" by any historical standard. I was just looking at the figures; I have them here. The stock of bond purchases stood at £435 billion before the crisis. In March 2020, the Bank went for an extra £200 billion. In June 2020, it was an extra £100 billion on top of that. In November 2020, it was another £150 billion of further purchases, and then in May this year you voted against £50 billion of it. We are talking about real money anyway at this stage, aren't we?

Andy Haldane: We are talking about real money. We will have done more by the end of this year on current plans since the Covid crisis than we did in the decade after the global financial crisis. That is serious money, edging up towards £1 trillion of QE and interest rates at zero, give or take. By any historical standard, that is a pretty accommodative monetary stance. We have a pretty accommodative fiscal stance, as I am sure you have also spotted. We have an economy bouncing back to base pretty vigorously, as best we can tell.

That begs the natural question about where the balance of risks in this economy lies. I would make one point on that in addition to what I have said previously. The situation we need to avoid like the plague is one in which inflation expectations adjust before we do, or where we wait for proof positive that effects on inflation are not transitory before acting, because in both of those cases that would be doing too little too late, and running the risk of inflation pressures becoming embedded, in the words that Jon just used, and us therefore playing catchup with monetary policy.

With this degree—unprecedented in peacetime—of both fiscal and monetary stimulus being injected into an economy that is now returning at pace to base, and perhaps above base, that is why I reached my own judgment on needing to turn off the tap.

Q202 **Mr Baker:** I am sorry to interrupt you, but I am over time. Would you expect a taper tantrum as that tap started to be turned off?

Andy Haldane: It depends very much on how it is communicated. That was the experience of the Fed. There is no necessary reason why you need to scare the horses or cause a tantrum, provided you communicate early, gradually and clearly. As and when the time comes for the MPC to turn off the tap, I am very confident it will abide by those lessons and avoid any sort of tantrum.

Q203 **Mr Baker:** Thank you all very much. I particularly want to say thank you to Andy. It has always been a great pleasure to work with you on the MPC, and I am looking forward with great enthusiasm to seeing what you do with the RSA.

Andy Haldane: That is very kind, Steve. Thank you very much.

Chair: We have not seen the last of Andy here; he might be back with us in June. We look forward to seeing him then, but it is great to see him here now.

Q204 **Emma Hardy:** My questions are focused on the impact of events abroad, particularly in the United States. Governor, following the previous *Monetary Policy Report*, you told this Committee that you were not worried about inflation in the US. Has the surprise spike in US inflation to over 4% given you second thoughts?

Andrew Bailey: The story in the US has some considerable similarities with our story. That is why the Fed is also talking about transitory effects. There are some differences. They have the same temporary effects as we do, particularly because energy prices are global. By the way, you will always see somewhat bigger percentage increases on the whole in US inflation, particularly with energy prices, because the tax wedge is smaller in the US—it is bigger in this country—so the percentages tend to move more. They have the same story.

Where there is a difference, and it needs to be watched very carefully—let me be clear that I am not going to enter into this debate, because it is a US debate—is that there is a bigger fiscal stimulus to demand in the US. The first fiscal stimulus package was voted through in its entirety. Many forecasters did not expect it to be voted through in its entirety. Fiscal policy in the US in the short run is giving more stimulus to the economy. It has a somewhat different approach to fiscal policy here, so we are seeing more stimulus there.

In the US, they are still asking the same questions that we are asking, about the transitory versus permanent nature. Their cycle is somewhat ahead of ours because the economy is recovering more quickly than our recovery. In terms of predicted levels, which is how we tend to do it, the forecast in the US suggests it will get back to the end-2019 pre-Covid baseline a bit more quickly than ours, though we have brought ours forward too. They are a bit ahead of us. They are looking at the same things as we are. The signs of pressure are somewhat greater. There are reasons for that. Some of the base effects will show up in bigger percentage changes, for reasons to do with the structure of the US economy and taxation.

Q205 **Emma Hardy:** With the Fed openly aiming for a period of above-target inflation, there are obviously concerns about how that will affect the UK. Are you concerned about this?

Andrew Bailey: It is something that feeds through into our forecast. We have a world forecast, which feeds through into the UK forecast, so in that sense we have taken it into account. Let me also reiterate a point that Michael made earlier. We do not have average inflation targeting in the UK, and there are good reasons for why we are different. One particularly good reason is that, if you look over the last decade since the global financial crisis, US inflation on average has been well below the 2% target that the Fed has followed, whereas on average UK inflation has been much nearer to the target.

There are all sorts of reasons you can adduce for that, but one is that the UK is a much smaller and more open economy. You therefore get feedthroughs, particularly from exchange rate effects, in ways that you will not get in the US because it is a more closed economy. That tends to have the effect of keeping inflation nearer to target. I will say one thing about the situation we are in at the moment. One of the offsetting factors to the stories about global prices is that sterling has appreciated over recent months, which will exercise some downward pressure on trade prices.

Q206 **Emma Hardy:** While in the UK and Europe we worry about economic scarring, the US is being forecast by the IMF and others not just to recover but to exceed its pre-pandemic growth path in the coming years, supported by fiscal and monetary expansion. If borne out, would this vindicate a strategy of running the economy hot with a very large stimulus?

Andrew Bailey: I have to be honest with you: going back to the conversation we had earlier, this mix of an economy that is bouncing back and inflation that has this hump effect in it but returns to target does not suggest to us that we need more stimulus at the moment. We have fiscal stimulus this year, and then, as the previous question mentioned, it starts to come off. That is pretty appropriate, frankly, for the current setting of policy in this country. I would not want to see it differently from that. I am pretty content that we are in an appropriate policy setting at the moment. There are differences, such as the difference between open and closed economies. The US is a very large economy and, in that sense, channels of monetary policy will be different, so you cannot do exact comparisons.

Sir Jon Cunliffe: The US had a much smaller fall in GDP than we had. They are coming from a higher point. They did not see that huge dip that we did in the spring of last year. It is a very different economy in terms of its growth.

The other point I would make about fiscal policy is that it has to be sustainable and credible. As the issuer of the world's reserve currency, the US probably has more space than any other economy when it comes to fiscal stimulus. If the fiscal plan is not credible, you could have the opposite effect in actually putting up interest rates and choking off.

It is very interesting: their pattern of support was different to ours and the Europeans'. We supported jobs, effectively, and they supported incomes. They allowed unemployment to rise but wrote cheques to households and the like. That seems to have left them with higher unemployment and higher inactivity, but more spending power in people's pockets. It will be very interesting afterwards to compare the different responses that people took, but that may. In our assessment, their stimulus is responsible for only a third or so of that growth. The rest is to do with the fact that it was a lower trough and the US economy in general.

Q207 **Emma Hardy:** Do you think the US is able to do a lot more of this because of the global status of the dollar? Is that what makes the difference?

Sir Jon Cunliffe: That makes a difference. It does make a difference to fiscal policy. The long-term issues around the US fiscal position are very different to the ones that apply to the UK, yes.

Q208 **Emma Hardy:** The forecast envisages net trade subtracting 2% from the economy in each of the next two years as imports race ahead of exports. Is this because of the UK vaccination programme, which is more than many major trading partners, or does this widening trade deficit pose any risks?

Sir Jon Cunliffe: Some of the trade performance in the shorter term is to do with the fact that the economy, in Covid and coming out, switched more to goods from services, for pretty obvious reasons. That is one of the issues behind the cost pressures that you are seeing on the manufacturing side. Of course, we import goods. We can manufacture our services, and they tend to be manufactured locally rather than imported. That is one thing that is driving it.

On the UK trade deficit, what matters most of all is the credibility in the institutional framework that allows the trade deficit to be financed and UK investment abroad. People often point to this, but the UK has run a trade deficit for most of my working life, but it has been offset by the impact of UK investments abroad. It is really important we keep the credibility of the fiscal and monetary framework, because that is what allows that to be sustained. You will see some impact in the shorter term from goods. Like many others, our assessment is that there will be an impact on trade coming from Brexit.

Q209 **Emma Hardy:** The pandemic is far from being under control on a global level. What risks does this pose to the UK economy?

Andrew Bailey: It is a very good question. Clearly, this is a global shock, so we cannot imagine the UK economy in the context of Covid as cut off from the rest of the world. We are seeing this in this country, because the pattern of the lifting of restrictions is moving further ahead in the domestic economy than it is in overseas travel, for instance.

The whole question of the impact on other parts of the world is very important in that sense, through two channels at least. There is no question that, if the pandemic is not controlled across other parts of the world, it will affect the UK economy through the normal channels of economic activity, but it will also affect it through the channels of confidence, in terms of confidence that the pandemic is under control. One of the downside risks that remain in our forecast is that there is a spread of a variant that is not within the reach of the current vaccination programme.

This question about the global nature of Covid is important. By the way, in the context of the UK holding the presidency of the G7 this year—and the Chancellor and I have been very active on this front—that is why we think this is a very, very important question. We will be meeting later this week with G7 Finance Ministers and governors on this question.

Q210 **Anthony Browne:** I might be mistaken, but I think we have just had about two hours of discussion of economic policy without mentioning the dreaded B word. I am afraid I am going to bring it up: Brexit. At the end of 31 December last year, we came to the end of the transition agreement and we started the new UK-EU trade rules. That was previously seen as one of the biggest economic events of our generation, but it obviously got drowned out by the impact of the pandemic. My questions are going to be focused on what evidence there is of the impact of moving to the new trade deal on our imports and exports with the EU.

Andrew, has the dust settled yet on what happened at the new year? Can we distinguish what happened from the pandemic from what happened from moving from the single market to the new trade deal? If so, what was the change?

Andrew Bailey: I fear I lost a bit of that. Hopefully you can hear me.

Anthony Browne: I can hear you, yes. Has the dust settled on what happened at the new year, given the change from the transition deal to the new trade deal? Can we disentangle that from the pandemic and, if so, what has been the impact of the trade deal?

Andrew Bailey: It is going to take quite a while and quite a lot of data to really do a systematic separating of Covid and Brexit effects in the short run, to the extent that we will ever be able to do it precisely. You can have a go at it by comparing trade with the EU versus trade with the rest of the world. That is one way of looking at it. We are still fairly light on data; let me be clear.

In our forecasts through last year we had two effects from Brexit. One is the longer-run effect. It is frankly too early to tell anything much on that. The other is the shorter-run disruption effect to trade. Our best guess—and it was that, frankly—was that we would see a more abrupt effect in the early months of this year, which would then taper off through to the end of the first half. The data so far broadly support that view. We saw quite an effect in January; as you say, it is hard to know how much is Covid and how much is Brexit. We saw some of that coming off in February, and we are still waiting for more data.

Let me say a couple of other things. There is a puzzle in there. The puzzle is why exports to the EU recovered more quickly than imports from the EU in February. Let me be clear: trade data are not the most accurate things, so we have to take this all with a pinch of salt, frankly.

Going back to the sessions I do around the country with our regional agents, I am seeing two things. First, a lot of companies are adjusting to it. Secondly, there are some well-known parts of the economy, as we hear about on the news and so on, where either it is still difficult as we speak or they have genuine uncertainties about how it is going to play out as the remaining parts of the adjustment happen, given that there is still some way to go on some parts of it.

The consequence is that we did not revise our view in the forecast; in fact, we thought there was reasonable evidence that what we thought would happen was broadly happening, i.e. that this disruption effect would run off. We are still following that view. We have not yet seen anything to cause us to question that in a major way.

Q211 **Anthony Browne:** Andy, following on from the Governor's comments, what do you see as the impact on trade of moving from a transitional arrangement to the trade deal, and has it impacted different sectors differently? Have services been impacted differently from goods?

Andy Haldane: I do not have a huge amount to add to what Andrew said on that front. As Andrew mentioned, as best we can tell so far, the impact at both an aggregate level and a sectoral level has largely been in line with the judgments we made ahead of the start of the year. That noisiness in the data has meant it is difficult to figure out how much of this is short-run friction versus long-run impact of supply chains being reoriented or processes being reengineered.

It would be premature to say anything too brave and bold about us having got this exactly right from a judgment perspective, but by and large what we have seen is not greatly out of whack with what we were expecting going in.

Q212 **Anthony Browne:** Trade did go down but it has bounced back quite a lot. I know there have been quite a few reports from businesses that they are largely back to where they were under the transition arrangement. Is that your take?

Andy Haldane: Yes. As Andrew mentioned, we expected a hit of about 1% over the course of the first quarter. The trade data we have until March is not greatly out of line with that, we do not think. We expect those effects to be temporary and, therefore, to have disappeared as we entered the second quarter. We do not have any data yet on the trade side from the second quarter, but there is no reason to alter that judgment so far.

Q213 **Anthony Browne:** Your decision-maker panel survey shows quite a strong fall in uncertainty over Brexit since the new year. Maybe that is not a surprise, but I wondered what impact you thought Brexit uncertainty is going to have going forwards on things like investment decisions, considering now that only a relatively small number of firms say it is a really big issue for them, but it is still in the top three for about a third of firms.

Andy Haldane: That has fallen from about two thirds to one third, so there has definitely been some dissipation of uncertainty through our decision-maker panel, as you say. For that set of firms, it is still having something of an effect, which is not that surprising as those new trade relations settle themselves down. Overall on the investment side, we have seen from successive decision-maker panel surveys that the investment intentions of companies are picking up, due to the combined effects of dissipating risks not just from Brexit but from Covid as well.

That, alongside the super-deduction we had in the Budget, is among the reasons why we have shaded up our business investment projections over at least the next couple of years. In turn, that is one of the reasons why our scarring assumption has come down a bit, to close the circle on the scarring discussion we had earlier.

Q214 **Anthony Browne:** Coming to financial services, clearly that has been a big subject for debate because we do not have a financial services deal as part of the trade deal. I wonder what your thoughts are on the impact of moving to this no-deal scenario in terms of financial services, and what impact that has had on exports, since financial services is our biggest export industry with the EU. I do not know who is best placed to answer that, because I know Andrew Bailey and Jon Cunliffe have both been quite involved with those discussions.

Sir Jon Cunliffe: In terms of financial services, jobs moving and activity moving we have seen what we expected to see. The numbers moving were a lot less than people had originally expected, as the wholesale banks and players in the UK established operations in subsidiaries in the EU and euro area and moved business to there. It is a bit early to say what the longer-term impact will be and how far over time more of that business will move.

There are a couple of obvious examples, one around the share trading obligation, which people know about, which is businesses trading in European shares moving to European locations. On the derivatives trading side, the interaction of the UK regime and the EU regime—because we effectively did the same thing—has had the effect of pushing some business to the US, because it has been impossible for some European firms to use either UK or EU platforms.[3]

We will see over time what the impact is. We have the clearing mandate, which is temporary until the middle of next year. We have to see what happens and whether that is renewed. At the moment, one is seeing what one would expect to see. Even though there was no deal on financial services, even equivalence for things that people talk about is not the same as the passport. One would expect that to happen. We had already factored some of that into our forecast over the last years because some of this started to happen.

If you are trying to interpret the trade data for the first quarter and on for the year, there is also the question of stockpiling. We do not know to what extent the very depressed trade we saw in January was just

[3] In oral evidence, Sir Jon said "UK or US". This has been corrected in the transcript at the request of the Bank.

because people had built stockpiles and were running those inventories down. The other interesting thing is that, if you look in the output data at the sectors that you might expect to be most affected by Brexit, manufacturing, etc., you do not necessarily see that big drop in output, but that might be because they are absorbing it in other ways. It could be that there has been some import substitution and the like, and it may just be that the trade data are very noisy and, to use your phrase, the dust has not really settled yet.

Andrew Bailey: There is a complication here as to how you think about trade in financial services. Let us say you move a trading platform from London to Amsterdam but the transactions are still being initiated in the UK. How do you think about that in trade terms? It is not straightforward.

Sir Jon Cunliffe: Some years ago, I looked at the German statistics, which suggested that they had a surplus in trade in financial services with us. It can be hard.

Anthony Browne: It is hard to disentangle those different things.

Q215 **Rushanara Ali:** Governor, you mentioned the G7. I wanted to bring it back to the IMF report about mass vaccinations. One of the things the report points to, which was recently in an article written by Gordon Brown, is that the cumulative gain would be £9 trillion by 2025, £3.6 trillion accruing to the advanced economies, which will recoup about £1 trillion in tax revenues. In terms of the return, we would get more than 35 times in trade and output what we would invest in vaccinations.

I am taking this opportunity because you mentioned the discussions you are having with the Chancellor. You, Sir Jon and others were involved after the financial crisis in international leadership roles to try to address the financial crisis and implications. Is there an equivalent that Britain can do through our Chancellor and your input to try to get the vaccination programme rolled out globally, so that it does not damage our economic gains in the future? We have a great deal to gain if we can find a way of financing it, particularly through the wealthier countries.

Andrew Bailey: The short answer is yes. It is obviously very important. By the way, it is more on the Government than the central bank side of G7.

Rushanara Ali: I appreciate that.

Andrew Bailey: If I speak for the UK presidency as a whole, it is a priority and it certainly features prominently in the discussions at the G7 in what we tend to call the finance track, for Finance Ministers and central bank governors. It is important; you are right.

Q216 **Rushanara Ali:** We are seeing some growth in vaccine nationalism and there is a binary discussion that has often happened in the past year around health and pandemic risks versus economy. This data is really powerful in showing what we can achieve in terms of economic output globally if we can sort out the vaccination programme and paying for it.

Sir Jon Cunliffe: That argument is understood internationally. This matters not just because it is abroad; it matters because you do not defeat the pandemic until we have a worldwide vaccination. This is for the Treasury and Government, but the UK Government are putting £1.2 billion or £1.3 billion into aid on the pandemic, of which the large bulk is development and distribution of vaccines. There is a contribution to Gavi, the fund that was set up under Gordon Brown some years ago. There is an effort going through the G7. The argument that aid abroad helps us is recognised more in the pandemic than it has been in previous crises. I am optimistic that it will be possible to provide some of that finance.

Q217 **Rushanara Ali:** We are looking forward to seeing progress in the G7 to get beyond the current commitments so that we can have the vaccination numbers reaching the kind of population scale we need in other countries. We can focus our minds on what is happening in India, which is meant to be one of our major trading partners post Brexit. We are meant to be doing trade deals, and if economies like that are on their knees it is not going to help us.

Andrew Bailey: I fully agree.

Chair: That brings us to the end. Can I thank our witnesses very much for appearing before us? It is always good to see you. Thank you for answering our questions on Greensill, not just in this Committee but with the very detailed response you gave to the written questions that we sent to the Bank prior to today. Thank you also for a very helpful discussion on the economy, inflation, monetary policy, what the likely nature of this very vibrant recovery that is ongoing at the moment is likely to be, and what we might discover when we come out of the other side of the bounce. In general terms, thank you all for all that you do to support the economy. When the story is written of the pandemic and the problems we have all faced, I suspect the Bank of England's contribution will be noted as having been particularly strong. Thank you very much indeed for all of that.