House of Commons

Treasury Committee

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

Monday 15 November 2021

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Harriett Baldwin; Anthony Browne; Gareth Davies; Emma Hardy; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 218-295

Witnesses

I: Andrew Bailey, Governor, Bank of England; Huw Pill, Chief Economist and Executive Director for Monetary Analysis, Bank of England; Dr Catherine L Mann, External Member, Monetary Policy Committee, Bank of England, and Michael Saunders, External Member, Monetary Policy Committee. Bank of England.

Examination of witnesses

Witnesses: Andrew Bailey, Huw Pill, Dr Catherine L Mann and Michael Saunders.

Q218 **Chair:** Good afternoon and welcome to the Treasury Committee's session on the latest Monetary Policy Committee report. We are very pleased to be joined by four members of the MPC. Will they briefly introduce themselves for the record, starting with Andrew?

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

Huw Pill: I am Huw Pill, and I have just been appointed chief economist at the Bank of England.

Chair: Welcome to the Committee. It is nice to see you, for what I am sure will be the first of many times.

Dr Mann: I am Catherine Mann. I was appointed as an external member of the Monetary Policy Committee in the middle of the summer.

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

Q219 **Chair:** Welcome to you all. I want to start with interest rates and inflation. The decision was taken at the MPC meeting recently not to raise rates, although it was a split decision. With inflation having constantly over-performed, compared with what the Bank of England had imagined it would be; and with all the uncertainty to do with its possible drivers lasting longer than many imagined—energy prices, labour market effects, supply chain bottlenecks and so on—how uneasy do you feel, Andrew, about that decision? I know you decided to keep rates where they were, but how much of a foot did you have in the other camp, and how worried are you about the uncertainties around inflation going forward?

Andrew Bailey: I am very uneasy about the inflation situation, as no doubt we will discuss at length this afternoon. I want to be very clear on that. It is not, of course, where we want it to be—to have inflation above target. The decision was a very close call, in my view, certainly speaking personally, and I am happy to explain the thinking behind my own decision. The phrase, "close call" reflects that; Huw has used it a number of times.

We now have more two-sided risks in the situation. On one side, growth in the economy has started to flatten out. In one way, that is not surprising, although we are not there yet. We might want to touch on this as well. We are gaining the ground lost from the start of covid, but as we approach that point, you would expect the trajectory of recovery to start to flatten out. But there is more to it than that. We are also seeing these supply-side effects. We have talked in the past about these two big moving parts in this recovery—supply and demand—and we are now seeing the supply bottlenecks definitely weighing on growth. We have been seeing that since the summer.

Against that, inflation has picked up further. The largest single reason why—looking at what has happened since we were last here and since the

August report—is the energy price sector, but it is also evidently coming from what I would call traded global goods prices, because these bottlenecks are in there as well. That in good part reflects the rebalancing of demand. We have had a period of goods-intensive demand, because some important parts of the service sector have effectively been closed down. That rebalancing is happening, but not as rapidly as we probably thought it would. That of course is putting strain on the supply chain system. Again, that is causing inflation to be higher.

On their own, however, those things ought to be temporary. As for all the proximate reasons why they are happening, I am happy to go into some of those, if it helps. They look to be temporary. By the way, monetary policy on its own—raising interest rates—is not, I am afraid, going to supply more gas or more computer chips. The risk for us is that we see in this recovery that the output gap is now approaching being closed, and the labour market in particular looks tight. That is the big issue at the moment.

If I stopped there, you would say, "Why don't you get on and do it?", and that would be a reasonable point to make. The real puzzle we have is what happened at the end of the furlough scheme. The furlough scheme came to a close at the end of September. There were more—I should strictly say "jobs", but obviously there are people attached to those jobs—people using it right to the end than we expected. It was somewhere around 1 million—possibly slightly over. We have little official data to go on at the moment to really determine what happened. Anecdote suggests the transition out of the furlough scheme has not raised unemployment, but we don't really know the full story.

You may have seen, because you had a hearing with the OBR recently, that the OBR forecast has a much larger upturn in unemployment as a result of the end of the furlough scheme than our forecast does; we have quite a small upturn. That shows you there's a lot of uncertainty around it, in a way.

I think that the situation is now looking considerably tighter. The risk, of course, is that if we get real pressure in the labour market, and if that transfers into real pressure in terms of wage negotiation—we can obviously come on to that—it could prolong the inflation, and could also lead to higher inflation expectations, particularly medium-term inflation expectations. That is a real risk. For me, the big question—others can obviously speak for themselves—was: do we wait six weeks until the next meeting, bearing in mind that we will start to see the picture then, and not say, "We're definitely going to do it next time," because that depends on the data? Do we wait at least wait six weeks and say, "Well, we'll have that read then, and we can make another decision," or do we act now? It was a very finely balanced decision, but I came down in favour of thinking that, given these two-sided risks—weaker activity and higher inflation—the labour market story really is the crucial part of it, and we haven't yet seen enough of that story, post furlough scheme.

Q220 **Chair:** Can I focus on the wage part of this? There is the danger of a wage-price spiral element to inflation. We had some economists before us last week, and we touched on this—in the 1970s, for example. The point was made that, structurally, the labour market is quite different today: you haven't got sector bargaining; you haven't got the level of unionisation, and so on. I would value your thoughts on that. First, to what degree are we in a very different world, where it is much more unlikely that this will happen? Secondly, do you have any up-to-the-minute evidence, one way or the other, as to what wage expectations are at the moment? Is there any survey data out there on that point?

Andrew Bailey: I will start, and colleagues may want to come in on this. You're right. Obviously, the structure of the economy but also the structure of the labour market is very different from that in the 1970s. I tend to, frankly, play down the comparison with the 1970s. Of course, by the way, the inflation story in the 1970s was much worse in that sense, and persistent throughout the decade.

When I talk to businesses—I do a lot of sessions around the country and sometimes virtually—what I get is a story of companies having to pay up to recruit people. That does not necessarily translate at the moment into paying their existing staff more. We are, by the way, in the wage settlement data, seeing quite an increase in the dispersion of settlement as well. That's partly because of that story, but it's partly also because obviously you have pockets of the economy—lorry drivers would probably be a good example—where you are probably getting more wage pressure, and then there's a lot of parts of the economy where you are probably getting not much wage pressure at the moment.

I would just add, and I say this as an employer, that of course eventually, unless other things happen, if you pay up to bring people in, you can live with different pay levels for a while, but it does become pretty difficult after a while, because staff can work these things out and so you get that pressure. We are not seeing that, I think, at the moment, but we could do. At the moment, companies are finding it very hard to recruit. I get this story consistently. They are having to pay up to recruit. But that is not necessarily translating through to their serving staff, if you like.

On surveys, Huw, is there anything you can raise?

Huw Pill: There is a survey that is run by the Recruitment and Employment Confederation. Without wanting to take up too much of your time, I think what Andrew said describes the latest results of that survey very well. It demonstrates that people who are hired new, or who are changing jobs, seem to be able to command something of a premium at present, but the data and information we have, including from the agents, suggests that has yet to spill over into wider wage dynamics.

I agree very much with the premise of your question, and with what Andrew said. A key issue is the extent to which what we still see as transitory pressures in headline inflation, stemming from energy prices in particular but also the international development of goods prices, spill over into more persistent domestic wage-price dynamics. That is a key issue, and we are watching it very closely through this and other measures.

Dr Mann: We have been talking a lot about wage as a very important ingredient in wage-price spiral, but we also have to consider the pricing part of the equation. The question is whether firms will be able to pass through to prices any wage increases that arise in the course of recruiting. We have information about the relationship between firms' sales and firms' pricing strategies. It is in the *Monetary Policy Report*; it comes from our decision-making panel, and it is a very large data set of firms. We see a positive correlation between high sales growth and high prices. On the other hand, the chart that you see in the MPR is driven by products and goods.

We have to ask, going forward: do we think that firms will experience as strong a sales growth next year as they have enjoyed this year, especially if they are producing goods products? There are a number of reasons to wonder whether firms can pass through those prices, because going forward, consumers will be spending a larger part of their disposal income on energy and food. This rotation away from purchasing goods has been really the centrepiece of the inflation surge, outside of energy.

Will consumers be able to spend as much on goods and services in an environment where a chunk of their pocketbook is being spent on energy and food? The answer is probably not, so going forward, the ability of firms to pass through any cost increase, one for one, on to their prices is in question. It is part of that slowdown in global demand and domestic demand, but it is accentuated by the fact that the proportion of the pocketbook that can be spent on goods and services will be eroded by energy and food prices. That is one of the reasons why I see a potential softness in this pricing power of firms. That puts a damper on inflation prospects in the medium term.

Q221 **Chair:** Thank you, Catherine. While you are with us, on the committee I think you did not vote for a rate increase, but did for QE. Is that right? Could you explain the nuance of the position that you took?

Dr Mann: I will start with an observation. The most recent asset purchase programme, which we are talking about, was put into place about a year ago, when conditions and prospects were really quite different. Back then, the Q4 2020-21 growth expectation for GDP was 11%, whereas the current projection is 6.7%. Back then, inflation was projected to be 2.1%; now it is projected at 4.3%. The unemployment rate back then was projected to be 6.3%, instead of our current projection at 4.5%. It was very clear that the asset purchase programme was appropriate at the time, given the expectations for the out-turn for the macroeconomy. On the other hand, data and conditions change, so it makes sense to evaluate the policy stance in the light of those changed data and prospects.

Secondly, as Andrew said, compared with September of this year, which was my first meeting, both domestic and global activity, while still strong, have moderated.

We have already talked about the labour market indicators and how they give us some cross-currents in, on the one hand, lots of vacancies and lots of recruiting difficulties and, on the other hand, some concerns about labour force participation and overall labour supply. We have already talked a lot about inflation; it did surge. We also observed that we had a significant increase in Government bond yields—the yield curve steepened quite a bit. With those cross-currents in the data for the macro economy, I agreed with the majority to keep the Bank rate at 0.1%. I noted, along with the majority, that the Bank rate was likely to increase in the current months.

On the other hand, I noted that some private financial market indicators did not seem to be incorporating this heterogeneity of incoming data, or the prospects for the real economy, or the trajectory for the Bank rate. Financial market turbulence, even if it is not a financial stability risk, can affect macroeconomic performance through the channels of consumer confidence and business investment uncertainty, so we would like to avoid financial market turbulence. To nudge the financial market behaviours, it was my judgment that it would be appropriate to remove some of the monetary stimulus to asset markets by terminating the asset purchase programme at the November meeting. It was a balance between the real economy and private financial indicators.

Q222 **Chair:** Thank you very much. I have a final question. Michael, you voted for an increase in the rate and to withdraw some monetary stimulus. You have listened to Andrew’s finely balanced explanation as to how he arrived at a different decision. Where do you disagree with him?

Michael Saunders: Actually, let me first say where I strongly agree with him—*[Laughter.]*

Chair: You are not a politician; you can answer these questions.

Michael Saunders: There is no risk of a wage-price spiral in the UK. Talk of a return to the ’70s is completely misplaced. The economy has changed in many ways since then, and an extra fundamental change is the institutional policy set-up, with an independent central bank, a clear remit and effective policy tools.

Having said that, the labour market is tight, with widespread skills shortages across many sectors. We have seen average weekly earnings growth; once you strip out competition effects, the underlying pace of pay growth has picked up to a little above the pre-pandemic pace. As Andrew said, pay growth for new hires is picking up. I felt, given that evidence, that the likelihood of a further pick-up in the generalised pace of pay growth was sufficiently high that we should start now to withdraw some of the stimulus that has been put in place over the last year or two.

Q223 **Chair:** So your thought is that there is some upward pressure on wages, and evidence of that, but not enough to get anywhere near a wage-price spiral situation at some point in the future. There are pressures in that direction but not enough to take off.

Michael Saunders: Talk of a wage-price spiral is just completely wrong. My concern is just that without a tighter policy stance—withdrawal of some of the stimulus—we would have a persistent inflation overshoot relative to the 2% target. But please do not characterise that as a return to the '70s.

Q224 **Chair:** No. I do not think anybody is suggesting a return to the '70s. This is a distinctly different environment. Does any other witness agree that a wage-price spiral is just never going to happen—that it is just not a possibility, forget it?

Andrew Bailey: The labour market is so different, as we have said—that is the point. The collective bargaining situation is very different. There is more competition in the economy as well; that is another important feature of the change from the '70s. Catherine is right: that will put downward pressure on the ability of firms to pass on these costs, which of course, will feed back into what eventually will—

Q225 **Chair:** So no chance of a wage-price spiral?

Andrew Bailey: Michael is right: it is a rather dramatic term from the past. We are a very long way from the '70s, put it that way.

Huw Pill: I think it important to emphasise the first part of what Michael said: the institutional set-up for monetary policy is different. We have an inflation target. As a newcomer to this experience, one thing that is quite telling about my directions with other members of the committee is that there is a strong focus on achieving that inflation target. That is very different from the experience of the 1970s, where the anchoring of prices, inflation, wage dynamics and so forth was much weaker than now because we did not have the framework in place.

Chair: Thank you very much.

Q226 **Anthony Browne:** I have a few follow-up questions about the Monetary Policy Committee's decision and the communications around it. Andrew, you gave your reasons for your vote to hold interest rates at the level they were, but you said in October that the Bank will have to act. When you see inflation rising, isn't there a risk if you leave action too late? Isn't it better, generally, to act earlier rather than later?

Andrew Bailey: In the answer to the previous question, I tried to set out, because we have these two-sided risks, why I thought it was appropriate to wait to see more evidence on the labour market, and I think that answer, in a sense, covers this question as well. As Michael set out, of course you can make the argument for doing it now. It is a very closely balanced argument. I felt that, on balance, there was something to be said for waiting to see the evidence on the labour market from the official data, which we will start to get tomorrow, interestingly; although tomorrow's release for the quantities will be September, while the furlough scheme was still going on, one particular piece of evidence, which is the HMRC PAYE employment data, will relate to October.

Q227 **Anthony Browne:** In terms of the communications around the decision, you did say in October that the Bank will have to act. That was certainly seen as a signal by the markets that you were going to vote for a rate rise.

Andrew Bailey: Some in the market.

Q228 **Anthony Browne:** Have you been an "unreliable boyfriend", to quote the former Governor?

Andrew Bailey: I spoke at a leaving do for a colleague last week and said, "You have gone from one unreliable boyfriend to another one." No, actually. Let me explain the point behind this.

Q229 **Anthony Browne:** There seems to be a bit of a disjunction between the messaging the market got and what the final decision was.

Andrew Bailey: Hang on; let me explain, because I don't agree with you on that. What I said in October was the following; it was a deliberately conditional statement about the framework, the target and my concern that we have reached a situation where some commentators believe that central banks—I am using that term in the plural now; it is not just the Bank of England—faced with a choice between supporting activity or meeting the inflation target always choose the former. That is not true. I can only speak for the Bank of England now, but as Huw was saying, we have an inflation target, and that is our objective.

It concerned me that there was a view that, whatever we say, the actual reality was that we were doing something different in a situation where, as we have been discussing, inflation is rising and is above target. So what I said there, which was particularly aimed at one of the most serious pieces of evidence that we would be going astray in my view, was that if we saw a de-anchoring of medium-term inflation and medium-term inflation expectations, we would have to act, and we will act. I did not say, and I do not think anybody else has said, "Therefore, we will be raising rates in November." That was never said, deliberately; we would never say that, because that is obviously an unconditional statement, and we make policy meeting by meeting. But as a point of guidance, in terms of re-emphasising the primacy of the inflation target and the link to medium-term inflation expectations, I thought it was critical that we put our foot down at that point, because I am concerned that there is a view in some quarters that we have gone off that and just never admitted it; that is not true.

What we said in the minutes and the report in November were actually consistent with that. We said, "We believe, if the economy evolves as the forecast suggests, that we will need to raise rates." We then made clear that we would do so. We used the term "coming months", which ties back to what we have just been saying about the data on the labour market. It is not a particular meeting. I think Huw said that all meetings are in play. It is important to emphasise that. Those two statements are consistent.

I accept that the markets have to take our conditional statements and translate them into unconditional views of the world—that is what they do. I would say, though, that all the evidence we have is that the vast majority of market economists, as far as we can tell, took the same view leading up to the meeting that we did—that it was a very close call. There was a poll of 45 market economists and they were 23 to 22. That is pretty fair, actually, as a judgment. There were some people, or some institutions, that took very big positions, and had been taking very big positions over the autumn, and some of them have lost out. Some others have gained, I think, but clearly some feel better than others.

Q230 **Anthony Browne:** Was that expectations management—it affected the expectations of some players in the market? Was that unfortunate or accidental? Are there any lessons that you have learned from that about doing this? I remember your predecessor commenting on future interest rate rises and saying that the next move will be up. I cannot remember when that was—it was 2012 or something.

Andrew Bailey: We have gone through various iterations of guidance over the years. At the moment, we are of the view, particularly with the high degree of uncertainty—there is a very high level of uncertainty at the moment in the economy—that making statements of the sort you just said would be hazardous, frankly, to say the least. I am not personally convinced that it is a good thing to do anyway. On the guidance, if you can call it guidance, the point I was making in October was about the framework. It was, "Don't forget what our framework is. It's about inflation." We are in the price stability business.

Q231 **Anthony Browne:** Another issue is the monetary transmission mechanism. There is quite a lot of speculation that you might find it is not as strong as it was some time ago because—through the mortgage market, although there are different mechanisms—there are fewer people with mortgages now as a proportion of households, they are longer term and there are more fixed-rate mortgages. Are you worried that when you pull the monetary policy lever you might find it does not have as much effect as you might hope? I do not know if that is a question for you, Andrew, or Huw.

Andrew Bailey: We have to keep studying the transmission mechanism because it changes, as you say. The mortgage market is a primary part of it and there are more people on rather longer fixed-rate mortgages, so we have to factor that in. Over my time—I have been in monetary policy for 20-odd years, off and on—our view of the duration over which the transmission mechanism works out has probably lengthened somewhat.

Huw Pill: I agree with that. It is important to put that comment in context. We have spent a lot of the last decade-plus experimenting with a whole new set of monetary policy instruments—maybe we will turn to some discussion of those later; Catherine has already commented. Inevitably, there was much more uncertainty about how what were initially introduced as unconventional instruments in the aftermath of the financial crisis would operate. In some sense—this is reflected in my decisions over recent months since I joined the Bank—going back to an interest rate-based signalling and operation of monetary policy as the core is really turning back to an area where we have more knowledge, hopefully. That perhaps gives us a little more confidence in how we can assess transmission although, to your point, as the structures in financial markets change, nothing is ever for certain. We live in an uncertain world.

Q232 **Anthony Browne:** Michael, I will come to you. You voted for an interest rate rise to 0.25% and obviously you were outvoted—that is democracy; that happens. I wonder whether you are worried about the consequences of not raising interest rates in your latest meeting. Do you think that that will lead to inflation running out of control or at least missing the target? We are not going back to the 1970s—you do not have to repeat that bit—but what are the damaging consequences of not having raised interest rates, which you wanted to do?

Michael Saunders: In general, the risk of delaying too long is that, if and when interest rates do have to rise, they have to go up a little faster and potentially a little further. I would put the risk in those terms. But also, the risk is that inflation expectations, particularly among households and businesses, might drift up a little further.

If I may, I will come back to your point about communications. Monetary policy is most effective if the expectations of households, businesses and financial markets for interest rates over the next few quarters—the next year or two—are broadly aligned with returning inflation to target, and if households, businesses and financial markets broadly understand our reaction function, in the sense that if the economy is weak and needs support, we would loosen policy, and if the economy is stronger and inflation is a problem, we would be more likely to tighten policy.

But it is not possible—nice though it might sound—to be able to promise where interest rates are going to be six or nine months out, because that depends on what the economy does, and there are inevitable uncertainties about that. In terms of meeting-by-meeting decisions, when I come into each meeting, I don't know how everyone else is going to vote, so there are always uncertainties over the decisions from month to month. In theory, we could get rid of that by deciding at one meeting that we are going to change interest rates at the next meeting. Then, when we announce it, no one would be surprised by it, because we would have told you previously. But that would be a futile thing to do, wouldn't it?

So it is really not possible to remove all uncertainty about decisions from monetary policy, either over the medium term, because it depends on the economy, or from month to month. What we do try to do is discuss our views on the economic outlook to try to ensure that those broader points—that interest rate expectations are more or less aligned with returning inflation to target and that our reaction function is well understood—get through.

Q233 **Anthony Browne:** You also voted to cease the asset purchase—the quantitative easing—programme. Why did you do that?

Michael Saunders: I have been voting for that for several months; I voted that way at the August meeting and the September meeting. We have talked about the inflation pick-up, and part of that is increased energy prices, which are likely to have a transitory effect on inflation and raise inflation for a period, which will then fade away. There is also a pick-up in global goods prices, which is likely to have somewhat more persistent effects on inflation here. And we have seen a gradual shift to a tight labour market, signs of a pick-up in pay growth and rising service sector inflation. That is the part of the inflation outlook that I am most concerned about, which is why I have been voting for a withdrawal of some of the policy stimulus over the last few months, starting with the end of the asset purchase programme a few months ago and then, as that nears its natural end, moving on to higher interest rates.

Q234 **Anthony Browne:** My last question is for the Governor. You voted with Huw to continue the asset purchase programme. Why did you do that? Is it because, having announced the total of £150 billion, you felt that you had to complete it, or were there other reasons?

Andrew Bailey: Two points. Michael has led into the first one, which is that we are very near the end of it. It only has about four or five weeks to go now, so the fact is that there is not much left. That is important, because when you hear about tapering in the context of the Federal Reserve, they are doing open-ended QE—in a sense there is no limit to it. Tapering is of course a critical decision. We are almost "tapered out", in their language. The reason that is important is that we have adopted a different approach of doing fixed amounts of QE.

Catherine is right in her characterisation of where we were exactly a year ago. Remember that we had covid returning and the economy facing that. We did not have vaccines at that point either, so it looked very different. Catherine is right to raise the question of, "The world has changed. How long does it go on for?" My concern, given the small amount left, was that if we stopped it, we would be raising a quite substantial question mark in the future, should we need it, as to, when we announce fixed amounts of QE over certain periods, would the markets say, "Yeah, but you don't really do it, do you?"? I felt that it was not worth compromising on that point, given the small amount left.

Q235 **Anthony Browne:** It was about future credibility.

Andrew Bailey: Yes.

Q236 **Julie Marson:** I want to go back to you, Governor, and maybe try to press you. You referenced the term you used in the press conference about interest rates—"coming months". Can you give me more detail? Is it two months or 10 months? What is your expectation?

Andrew Bailey: Huw has made the point that every meeting is in play in that sense. I don't want, because that really would fall into the trap that I was seeking to avoid in October, to say, "Yeah, but this is the really important meeting." That is not the case at all. It so happens—we meet every six weeks, and the labour market data come out every month—that we will have two sets of labour market data between the last one and the next one. That will straddle over into October properly, so we will have the first set of post-furlough labour market data. Now, what they will reveal remains to be seen and, in the meantime, we will have a lot of other data. We will have an inflation number this week as well, for instance, and we will have a lot more activity data. Sorry, I don't want to sound evasive, because I am not meaning to, but it really is important when we say "coming months" that every meeting is created the same, in that sense; it's just that some come sooner than others.

Q237 **Julie Marson:** I take your point. Let me try a "what if" question. If, for instance, recovery was in line with your central forecast, what would your expectation be in terms of the timing?

Andrew Bailey: We would have to make a judgment about how solid we felt the data were, and how confident we can be with that going forwards. What you should take clearly from the statement we made in November is that if we pass that test, then in our view the interest rate should rise.

Q238 **Julie Marson:** In terms of the levels, how high are they likely to go?

Andrew Bailey: Again, I am not going to take a view on that. There was an important point in what we said in the report and what was said in the press conference. We condition the forecast on the market curve at the time. It is a 15-day moving average leading up to the point at which we do it. That curve suggested that at the outer point of the forecast in three years' time, we had inflation a bit under target but, probably more importantly, we had a negative output gap opening up, so that the trend line would then be inflation falling further below target. We gave a fairly clear message—I do not think it was very subtle—that that did not look like it was in line with where we would want to have it. So, in a sense the market curve was not where we—at that point. It has changed since then.

The second point in that context is that, going back in time, the MPC used to condition the forecast on constant interest rates, not the market curve. We still produce the constant rate forecast, but it is not the main one any more. It is probably more interesting this time, because the constant rate forecast tells you that inflation does not return to target. It sticks around 2.6% or something like that. That is obviously significant in terms of what we need to see policy do, if things evolve as predicted.

The market curve has rates going up from 10 basis points, where we are now, first to 25 and then another three 25s next year. We are not endorsing any curve, by the way; that is a matter of fact, rather than an endorsement from us.

Q239 **Julie Marson:** Thank you very much. Charlie Bean invoked the material risk of 1994. I think you saw that—a steep rise in bond yields, interest rates rising—

Andrew Bailey: Market shock.

Q240 **Julie Marson:** Yes. How much of a risk would you say that is?

Andrew Bailey: With all due respect to Charlie, who I hold in enormous respect, I am not with him on this one. As Huw was saying earlier, we are now in a very different period. The critical point to make here is that we have been in a world of very low interest rates since the financial crisis. That is driven by underlying structural reasons in the world economy, particularly to do with ageing populations. We do not see that basic context of low interest rates changing, for the foreseeable future.

The reason this is important is that when we talk about interest rates going up—certainly, I talk about interest rates going up—we are talking about it within that context. We are not talking about some move back to a very different environment in the past.

Q241 **Julie Marson:** Do any of the other witnesses want to expand on any of that?

Dr Mann: Charlie Bean and I are both MIT PhDs from the same cohort and come from the same background; I suppose we can say that. First, it is important to note that one of the factors in today's environment is that we saw a very big change in Government bond yields around the world in recent weeks, but we did not see a similar change in private financial market indicators. So, there is a disconnect between the interpretation of the state of the world from the standpoint of Government versus the standpoint of the private sector and private sector finance. That disconnect is important to keep in mind when thinking about the prospects going forward.

The other thing to consider in the context of how high Government bonds can still go is not only an emphasis on the demographics associated with long-term stable interest rates, but other elements that are relevant to that anchor. One of them is productivity growth. There is also capital stock, which is where business investment becomes an interesting aspect of the question, and labour force, which is where the demographics component is, and we have to think about risk premia and whether or not something is fundamentally changed on that variable.

The one or two that I look at as most important in thinking about long-term interest rates are productivity and capital stock. With both of those, we could be looking at a different environment going forward, with very strong productivity growth and robust investment, but that is not really what is in the projections. That suggests that the environment that Charlie is talking about is not the one that we are likely to return to any time soon.

Q242 **Julie Marson:** Thank you, Catherine. We have heard about different perspectives and votes. Do you ever get the impression that there is groupthink, or a danger of it, in any of the decisions?

Huw Pill: As a newcomer to this game, with Catherine, I might have a bit of a different perspective from others who have been in the game for longer. There is a healthy commonality in what we are trying to do. There is a lot of clarity—as Andrew put it a moment ago, we are in the price stability business—so we are not arguing about what our ambition is: our ambition is to deliver on the inflation target. That is a commonality across the group and a remit that is delivered by others to us, but there is a healthy debate, which is reflected in this room. Looking at the other three people at this hearing accompanying me from the MPC, they all voted different ways. That reflects the fact that a healthy debate is going on within the committee. That debate, however, is deeply rooted in a way of thinking about the world that allows that debate to be oriented in a healthy way.

For example, this afternoon I have listened to all three others—but Catherine and Michael—and it is not that I would repudiate those arguments and ask myself, "What are these people thinking?" Naturally, I have a lot of respect for my colleagues, but I have a lot of respect for the arguments that they are making, too. When I approach the problem, come to this issue and think, "This is a finely balanced set of decisions from an individual point of view, and a finely balanced set of decisions from the committee as a whole", that is because I recognise, on the one hand, some of Michael's arguments that if we do not act there is a danger that inflation will achieve some self-sustaining momentum that we will have to resist down the road. Equally, if we act prematurely, there is a danger that we derail some of the recovery, which is still in some respects quite fragile. It is balancing those two risks—the two-sided risks that Andrew talked about—and steering our way between them that is key.

We have a commonality of framework and of ambition, but inevitably when steering between those two risks, some people will fall on the one side and some on the other side. When we have nine people all making those finely balanced judgments, it is perhaps not so surprising that there is a little uncertainty about what any individual decision is in terms of magnitude, timing or the first set of things you asked about. However, that is a healthy reflection of the strength of the system, which brings some of that debate out transparently into the public domain, rather than suppressing it. I worked at a different central bank earlier in my career, as a staff member, and in that central bank there is a bit of a tendency to create a consensus, which in some cases might be an artificial consensus. I think that is probably not a healthy way to run monetary policy.

Andrew Bailey: Speaking as the chair of the committee for a moment, I regard as one of the most important things for me to ensure is that those different perspectives are brought to bear, so that we really deliberate on this. The real challenge—we saw it this time, and we owe it to the public out there—is to give as clear a message as we can. The crafting of those paragraphs in the statement, which try to meet those two objectives—there are different views in the committee, but we try to give as clear a message as we can as to how we are thinking and what we think will happen—is a time-consuming business. That is right, though, because it is critical to balance those two things at that point, without falling into the groupthink trap.

Julie Marson: Do you have anything to add to that, Michael?

Michael Saunders: No, I agree with that. You see the range of views among the committee members. I don't think groupthink as an accusation really has much bearing.

Q243 **Harriett Baldwin:** Governor, we as a Committee have been asking about inflationary risks all year. At the beginning of the year, your response was, "Well, inflation is well below the target." Later, it was, "We are expecting inflation to peak at lower levels than we are now." Now, of course, we are hearing this message that it is going to be temporary, but we are now looking at levels that are a multiple of your target. It does really concern me that the risks to inflation seem to be so much more to the upside than was anticipated by yourselves at the beginning of the year.

We have heard from all of you that you don't think a return to a '70s-style wage-price spiral is possible, and that somehow the labour market is different and so on. Governor, last time I asked you about the perception that the Government itself now had a policy of trying to raise wages, particularly for those who are the lowest paid and particularly making sure that wage growth responded to the fact that we have now left the European Union. I just wondered whether that feeds into your perception that wage growth is going to not be under enormous pressure in this changed economic environment that we are in.

Andrew Bailey: That is a very interesting question. Let me to try split out a number of different elements of it.

I think—this probably goes back to the discussion we had last time—it is important that we have a framework that enables, where appropriate, an adjustment in relative wages, because that can happen in the economy for all sorts of reasons. Let us take the obvious example. It may be that lorry drivers, HGV drivers, are relatively underpaid now. If that is the case, we should obviously not have a monetary policy framework that says, "Well you can never do anything about it." That is one reason why we have a 2% inflation target, not a 0% inflation target. If the target was 0%, it would be hard to manage any of that.

Obviously, the challenge you then get is that it is all very well to say that, but how does it work in practice? Does that not create these second-round effects on wages that you might talk about? That is where we have to make, frankly, very difficult judgments. I am afraid that I suspect that we will have to do that over the coming months as we try to pick our way through the evidence as to what is going on in the labour market.

The other thing I would say is that I think the labour market has tightened already. We have talked about wages, but I will talk about quantities for a moment. It is quite interesting to compare back to the end of 2019, pre-covid. What we see is that unemployment is just over 200,000 higher. It is obviously an important number, but it is not anywhere near as big as we feared it would be. Inactivity—people who do not have a job and are not searching—is more at about 450,000 higher. That is split into a young age group who are continuing in education who we think will obviously come into the labour force after that, and an over-50s group where we have a real question mark. We just do not know what they will do—will they come back or won't they?

Public sector employment has grown by about 280,000, which is not a trivial number in the grand scheme of things. If you look at the shortfall in consumer service sector employment, which is still coming back, those two numbers more or less offset each other. That has tightened the labour market. Even more hazardous, we think that total population and therefore total labour force is probably smaller now than it was projected to be at the end of 2019, and possibly by 300,000 or 400,000. There is quite a lot of tightening of the labour market in those numbers.

Q244 **Harriett Baldwin:** And vacancies are at a record high—really significantly higher.

Andrew Bailey: Yes. Although there is the million number, just to do this on a comparable basis, they are about 300,000 higher than they were at the end of 2019. So, yes, the vacancy to unemployment ratio has gone up.

Q245 **Harriett Baldwin:** In relation to freedom of movement, that has ended and of course the Government are deliberately trying to use that to raise wage levels. It has very been clearly stated by the Prime Minister and by the Business Secretary that now that freedom of movement has ended, there is a very clear policy to use that to raise our wage rates.

Andrew Bailey: On the population number, I have to be honest— we cannot separate out Brexit and covid in that sense, because over the same time period they both have the same effect. So I honestly cannot give you a steer on that.

On the point about raising wages, having made the point about relative wages, more broadly the question, of course, is how does it tie into productivity gains? That is the important question, because obviously it is much more sustainable to raise pay when it is attached to higher productivity.

Q246 **Harriett Baldwin:** Although this Committee has looked a lot at productivity and I am sure you have too, I am not sure that we have seen anything that would make us feel that it is going to make a big shift at the current time.

However, I want to move on to a different topic, which is inflation expectations. Again, they have been cited when you have given us evidence in the past as one of the things that you monitor very closely. I want to turn to Huw now and ask about the speech that your predecessor made in his final salvo, saying that "inflation expectations and monetary policy credibility feel more fragile at present than at any time since inflation-targeting was introduced in 1992." What is your view on inflation expectations? And can you factor in your reaction to the paper by Dr Jeremy Rudd about whether or not it is wise to think that inflation expectations are a good anchor for central banks to monitor?

Huw Pill: The first thing I would say is that we have seen rises in short-term inflation expectations in recent months, and we largely associate that with the rise in actual inflation and some of the things that you just mentioned to Andrew, because the people reporting or pricing those inflation expectations are reflecting that they have risen in response to the same disturbances—the rise in energy prices and so forth—that to some extent have surprised the bank's forecast.

Where I think we probably agree with the paper—the Federal Reserve paper you allude to—is that we would put more emphasis on medium to longer-term measures of inflation expectations, which I think are more reflective of what is going on in feeding through to what is going on in pricing behaviour and—

Q247 **Harriett Baldwin:** As priced into index-linked gilts?

Huw Pill: Well, that's one measure.

Q248 **Harriett Baldwin:** What measure would you prefer?

Huw Pill: I think we have a box, which is in the *Monetary Policy Report* we published last week, and I think we try there to look across a broad range of measures—some measures coming from households; some measures coming from firms; some measures coming from other professional forecasters, both in the private sector and the public sector; but also financial market measures, such as break-even rates and measures derived from index swaps.

I think that if you take a kind of holistic view of all that—some work has been done in collaboration with the Bank to try and do that in a pretty structured way—we still draw the conclusion that, overall, those medium to longer-term inflation expectations remain anchored at levels that are, broadly speaking, consistent with our objective. And we draw some comfort from that.

However, what is important to recognise, which again is an element of what is discussed in the Federal Reserve paper that you mentioned, is that if those inflation expectations or any subset of them begin to move away from those types of levels—just to repeat: we don't see evidence of that as yet—that is a challenge, either to our analysis or our policy.

I think what is key in that respect is that we meet that challenge. Either we have to accept that those people reporting in the surveys or pricing the instruments that you mentioned are right and we are wrong, in which case we should change our assessment and change our policy—that's not where we are now—or we need to convince them that we're right and we have the right assessment and the right policy.

Either way, I think the first step in that process is to convince ourselves whether we believe what we're doing or not, rather than respond in some sort of mechanical way to the movements in, for example, financial market-based measures of inflation expectations, which can be difficult to measure and quite volatile on occasion.

It really goes back to the first discussion we had—or other discussions we've had this afternoon—which is: do we believe in our assessment of the developments in inflation we've seen? Are they really transitory, or are they becoming more embedded, through wage and price-setting behaviour, into longer-term developments?

Q249 **Harriett Baldwin:** What I am hearing is that you do think that shorter-term inflationary expectations are a bit of a lagging indicator and that they are responding to the fact that inflation has risen, but that the longer-term anchor is something you would still feel is reflecting confidence in your inflation-targeting framework.

Huw Pill: Shorter-term inflation expectations are really a reflection of actual inflation, to a large extent. Of course, we look at them; they are lagging, but none the less, we see actual inflation too, and that is the focus of our analysis to understand what is driving actual inflation.

What is more important in our assessment is looking to medium to longer-term inflation expectations. At the moment, we draw comfort from the fact that, in this kind of holistic assessment, they remain consistent—or remain at levels consistent with us achieving our objectives, so that is a pointer to our credit. That weighs a little bit against the comment from Andy you gave, but I think it is important that we treat those expectations as a prompt for analysis, rather than a response to the mechanics.

Q250 **Harriett Baldwin:** But do you accept that your inflation forecast this year has been wrong by a significant order of magnitude?

Huw Pill: If you look at the inflation forecast that was published back in the March *Monetary Policy Report* and compare with it now, there has been an error made and there has been a substantial revision. That is because of some of the factors that we discussed earlier, which were, for me as an individual—I was not in the Bank back in May—genuine surprises. The behaviour of wholesale gas and energy prices, and so forth, had been much higher than what was expected.

Q251 **Harriett Baldwin:** Thank you. I want to just ask Michael—

Andrew Bailey: It is fair to say, with respect to Andy and his 1992 point, the errors were actually larger in 2008 and 2011. That is not excusing it, but these things have–

Q252 **Harriett Baldwin:** You've been worse wrong before. Is that what you're saying, Governor?

Andrew Bailey: We have had larger forecast errors for inflation. The point is that inflation has gone up during the inflation-targeting period. We had peaks in 2008 and 2011 and the forecast errors were larger. That doesn't excuse—obviously we have had particular issues to deal with this time, but the 1992 point is not quite right.

Q253 **Harriett Baldwin:** I will just turn to Michael, if I may, because when we took evidence from the Office for Budget Responsibility, Sir Charlie Bean, in particular, was talking about the 1994 bond market. You may also remember that, in terms of how quickly bond prices shifted when confidence was lost in the ability of central banks to get inflation under control. You have said that you are not worried about the 1970s type of risk, but how worried are you about the 1994 type of risk, in terms of the bond market's reactions?

Michael Saunders: I wouldn't draw a close parallel to 1994. Then, we were coming out of a period in the 1980s in which nominal interest rates had been much higher—typically 10% or more—and as we moved into the 1990s, inflation expectations were much lower in the aftermath of the 1990-92 recession. However, there was a lot of uncertainty in the financial markets—which I worked in back then—as to whether, as the economy recovered, the normal level of interest rates would be 6%, which I think they had been cut to in early '93, or whether it would be back to the double-digit rates we had typically seen in the '80s. Markets were generally unsure as to what the normal level of rates were going to be and, for a period, priced for a return to the relatively high interest rates of the '80s.

If you think of the current position, we are in a relatively low neutral rate world; that has been the case for the last 10 years or so. The levels of interest rates in the UK have been much lower than in previous periods, and I think that is likely to continue. I must say, I think that is quite widely understood in financial markets—that sort of uncertainty as to whether we are in a low neutral rate world, which was there in '94. I don't think it is anything like as pronounced now.

Q254 **Harriett Baldwin:** You do not think, in both cases, you could be making the same recency bias error in your expectations about future price changes?

Michael Saunders: It would be a thing to watch out for. We do pay a lot of attention to various measures of inflation expectations, in particular, those among households and financial markets. They have crept up a bit recently, but I would still regard them as well anchored—I would not want to see them trending up further from here.

Harriett Baldwin: Nor would I, because my constituents who have a small amount of savings have seen these erode significantly over the last 12 months.

Q255 **Emma Hardy:** I am going to ask a quick question on debt before moving on to look at the link between low interest rates and higher housing prices. What is the Bank's view on how developments in the economy, and the likely path of interest rates, may affect households who build up debt in the pandemic?

Andrew Bailey: I will start on that. The current cost of debt servicing to households is well below what it was pre-financial crisis. It would require a very substantial increase in interest rates to take us back to that era. We have done some work on this: it would probably require something in the order of a 2% to 2.5% increase in interest rates to take interest payments as a share of household income back to the average seen between 1999 and 2006. Relatively speaking, compared to history we are in a period of low debt servicing costs. However, that needs to be looked at from the point of view of the whole distribution of household debts—I am talking about averages there.

If I can comment on the FPC for a moment, we have had household tools in place since 2014. To my mind, the most important tool there is that we have a limit on the flow of mortgages to those with loan-to-income ratios at the upper end of the distribution. We have always said that it is a 15% limit—the banks do not actually get near to that. There are cases where it is appropriate to loan at those rates, but it has helped to act as a guard rail to look not only at the average cost of debt servicing but at the distribution. This has brought the distribution back inwards.

Q256 **Emma Hardy:** I am going to dig a bit more into the comments about distribution. Some of the evidence I have read says that when you look at the data as the average for the country, the amount of debt seems low, but that is because in the pandemic some people have been able to save an awful lot and other people have not—that may skew the average. When we are talking averages, those figures may be skewed. When you are looking at the impact of possible interest rises on household debt, are you are looking at that across the range?

Andrew Bailey: I was not netting off saving against debt to get those numbers. You are right that there has been a substantial increase on household saving during the covid period—above the normal level. We think that is concentrated, relatively speaking, and probably concentrated in two groups. One group is those with typically higher incomes, who have tended to have more constant income, and the second group is the elderly, who have had fewer opportunities to spend. This is something that we think a lot about in the MPC context: what will be people's behaviour towards these unexpected savings?

Q257 **Emma Hardy:** When you are looking at what impact interest rates would have on a household, do you map out the impact on the different sections of society? If we are talking about differences in constituencies, my constituents are not so worried about their savings having high inflation; they are worried about servicing debt.

Andrew Bailey: There is a model—a set of models—sitting behind what we do and informing us. We also have the work of our agents around the country. There is a certain amount of regional data and we get quite a lot of survey-based information that we use. We are avid consumers of data. We do try to balance these things, but obviously we are setting monetary policy for the whole economy—that is the reality.

Q258 **Emma Hardy:** I am going to move on to the impact of interest rates on housing prices. To what extent do you think that low interest rates are the key driver of high house prices, rather than a lack of housing supply?

Andrew Bailey: I am sure my colleagues want to come in on this. Let me say a couple of things about what has happened since the covid period—it is very interesting. Two things are notable in the last 18 months. One is that we have seen a reversal of the regional pattern of house price increases that we had seen for a long time before covid. In other words, a long time before covid, the fastest rate of house price rises were in London and the south-east. We have actually seen the opposite during the covid period. The weakest rate of house price increases have been in London and the south-east, and the faster rate of house price increases have been almost everywhere else, it turns out.

The second thing that has changed is the distribution of house price rises across different sorts of properties. Again, pre-covid, we tended to see faster rates of increases in the price of flats. Now we are seeing faster price increases of larger houses outside London and in other parts of the country. Our agents have a great saying for this, which is the "race for space"—as opposed to the space race, which I just about remember as well. This is to do with working patterns and living patterns. People are taking advantage of living further away from their place of work and buying larger houses in areas that have lower house prices, which obviously is having a regional effect. I know there are colleagues who, no doubt, want to come in on this.

Huw Pill: The only thing I would add is to take note that, while house prices have been rising, for sure, and, in addition to this race for space, we have had the stamp duty holiday and other things relatively recently, but it is important to keep in mind a slightly longer-term, historical perspective. If you look at real house prices—house prices corrected for the movement in the price level in general—we are still not seeing a level of house price, or a level of house price relative to incomes, that is as high as we saw in, for example, the mid-1970s or the late 1980s. On the characterisation of the current situation as being a house price boom, I would probably characterise both the early to mid-1970s and the late 1980s as being house price booms in some sense. We are not in that characterisation now, so I think that is an important thing to keep in mind when debating this issue.

Q259 **Emma Hardy:** Catherine, did you want to add anything?

Dr Mann: I was just going to note that there is research in the Bank that has tried to tease out the various elements that you are commenting on. They ascribe about 50% of the price increases to this race for space—in other words, this shift in preferences. If that is true, on the marginal increases in price over the course of the next year or so, we would probably not see as much of an increase to the extent that people had made their adjustments. Of course, we could find more people wanting to move out, but more people are considering whether or not they will stay in the city as opposed to moving out. About 50% of the dynamic is associated with the race for space and, as you said, there are very clear price dynamics that are associated with stamp duty. That means at the margins the interest rate driver is not as prominent as one might think.

Q260 **Emma Hardy:** Thank you. That proves the point I keep making, Chair, which is that people should move to Hull because it is much more affordable, and you get a much higher standard of living and a bigger house, but I will park that for the moment. Can you comment on what is happening in New Zealand and on their Government's decision to instruct their country's central bank to consider the impact of its policies on the housing market, and then looking at the issue in a slightly different way?

Andrew Bailey: As I was saying earlier, we have addressed particular housing market risks through the Financial Policy Committee, and I think we are more content to do it that way than through monetary policy. The FPC is a different beast in that sense. It has a very big range of potential tools it can use. We are reviewing the housing tools at the moment, and we review them quite often because they are tools that, probably unusually for a central bank, have the most direct effect on individual members of the population, so I think it is appropriate that we review them and use them minimally.

Michael Saunders: If I can add something here, you, Parliament, set our remit. We will follow faithfully the remit which you set us.

Q261 **Emma Hardy:** Sadly, I did not get to choose. We are working on it. Compared with a few decades ago, far fewer younger people can now afford to own their own home, and rents take up a larger proportion of their income. To what extent are low wage growth and high housing costs a greater threat to the living standards of the young than the prospect of higher inflation and interest rates?

Andrew Bailey: I am sure colleagues will come in on this. I always find it interesting that, in this country, if you look at aggregate measures of inequality, at the very high level—I think Ben Broadbent may have made this point in the letter he wrote recently—we actually have not seen very large changes since the 1980s. What we have seen is intergenerational changes. The Institute for Fiscal Studies has done some very interesting work in the past that sort of cut the population up into which decade they were born in. I think it says that those born in the 1980s were the first decile, if you like, or decade to be less well off than their predecessors, measured on asset ownership, and possibly income as well. That is of course quite a big change, because that previous trend had been going since the second world war. Yes, I think we have seen changes in that respect.

Emma Hardy: There was a really good article on BBC News called "Seven reasons it helps to have rich parents", and one reason looked at this intergenerational impact. I think I have run out of time. Thank you everybody, and thank you, Chair.

Q262 **Siobhain McDonagh:** My questions are on the impact of the end of the furlough scheme on employment, reports of shortages and friction in the labour market and the impact that those will have on wages and growth. Andrew, in a recent speech, you talked about the "labour market puzzle" and the uncertainty over how it will be resolved. What are some ways you think that resolution will happen, and how difficult will it be?

Andrew Bailey: As I said earlier, quite honestly, we did not have in our previous forecast that 1 million jobs would be on the furlough scheme until the end of the scheme, in large part because the Government reduced the attractiveness of the scheme as it approached its tail end, which we thought would cause a reduction in numbers, but it did not—well, it did somewhat, but there were still far more on it until the end. The question is what happens next. That is obviously what we are waiting for in the data. However, I think that, broadly, those who were on furlough will return to their previous jobs. I think quite a bit of that has happened. I go around the country a lot talking to companies, and a number said to me that they took their employees back at the end of the furlough scheme either because they were experiencing a pick-up in activity or because they expect one. A good case in point would be some of the airlines, which said they expect activity to pick up—in fact, it is picking up now—and therefore took their staff back because they did not want to lose them and have to recruit new ones. I think that will have gone on.

I should say that I think just over half the jobs on furlough at the end of the scheme were what was called full furlough, and the other half were partial furlough—part-time jobs. Those on partial furlough could of course have gone into other jobs; by the way, it was not an abuse of the furlough scheme to have a job in another sector. There could of course have been people who already had other jobs, or got what they wanted elsewhere, and so when the furlough scheme came to an end they did not go into unemployment. Obviously, some people will have gone into unemployment. We have seen a bit of survey evidence around that I think. It is quite a low number; I think it is actually probably a bit lower than forecasts would imply.

Michael Saunders: Yes. There have been two surveys. One was a survey of firms by the ONS in its business insights survey. It found that, of people who had been on furlough in September, 3% had been made redundant since then. A survey of people by the Resolution Foundation released over the weekend found that, of those who had been furloughed in September, 3% were unemployed since then. In both those surveys, there are some people who might have gone into the jobless figures, but it appears that the vast bulk of those on furlough have gone back to work.

Andrew Bailey: We haven't seen a marked pick-up in redundancies—we haven't seen much pick-up in redundancies at all. They do not cover small firms, and we understand that there was quite a heavy usage of the furlough scheme by small firms.

Dr Mann: It is important to remember that forbearance, particularly by small firms, ends in March or April next year. Even the agents have raised a concern that there could be a shoe to drop with regard to the employment situation when that forbearance ends. That is another factor in the labour market dynamics to certainly to keep in mind.

Huw Pill: The surveys that Michael mentioned—notwithstanding what Catherine just said, which I recognise, too—suggest a little bit higher level of redundancy at the small 0-to-9 size businesses, but nothing dramatic, so at least the spire is not pointing in the direction that Catherine has said.

To link that to our forecast published last week, we were forecasting, anyway, a relatively modest rise—only a one-tenth of a percentage point rise—in unemployment in this fourth quarter on the back of the end of the furlough scheme. The type of information that we discussed would actually suggest unemployment becoming lower than that.

Q263 **Siobhain McDonagh:** On furlough, last week *The Times* reported that hundreds of companies set up after the Government's furlough scheme was established claimed up to £26.6 million from the taxpayer. Have you made an assessment of the level of fraud associated with furlough or other coronavirus financial support schemes?

Andrew Bailey: We haven't, I'm afraid. That would be a question for the Treasury, not for us.

Q264 **Siobhain McDonagh:** The *Monetary Policy Report* notes that there is a high degree of uncertainty about the near-term outlook for the labour market, especially given that the Government's furlough scheme closed at the end of September. Does that suggest that the unemployment rate forecast of 4.5% in Q4 2021 is unreliable?

Huw Pill: I think I may have inadvertently answered that question already, but there is a remaining answer. As Andrew said in response to an earlier set of questions, we will see more data tomorrow, which largely covers the third quarter, but also some payroll data for October—so after the end of the furlough. Then we will see more labour market data before our next meeting, so there are still a lot of shoes to drop in that respect. I don't know what that data is, so that is a residual uncertainty.

On the basis of the information we have now, to the extent that some of that uncertainty has resolved itself, it has actually resolved itself in a positive direction, assuming unemployment turns out probably slightly lower than we would have anticipated when we made the forecasts. The fly in that more optimistic view—at least, viewed through the lens of unemployment—is precisely the one that Catherine mentioned about the end of various schemes, which are sort of delaying winding-up orders and other insolvencies.

If that shoe is to drop at some point over the next few months, we might see unemployment rise as a consequence of microbusinesses going through that process. That remains the risk in the opposite direction, but the information we have thus far is on the other side.

Q265 **Siobhain McDonagh:** UK job vacancies are at a 20-year high, including over 105,000 vacancies in adult social care. However, there are recruitment difficulties, despite unemployment being above its pre-pandemic level. Why do you think that is?

Andrew Bailey: I gave some of the numbers earlier. We have seen the public sector expand. That is in a sense in competition in the recruitment market.

Through the covid period, we have seen an expansion of the public sector. We think the population—the labour force—is smaller than it was expected to be on the pre-covid trends. That would tighten the labour market and make it harder to recruit. As I said earlier, we have got this question mark about people who have gone into inactivity and whether they are going to come out of inactivity and re-enter the labour market. Again, all those things would contribute to the story that you are giving.

Q266 **Gareth Davies:** Governor, I want to ask about the economic outlook, starting with business investment, if I may. We are still seeing quite low levels of business investment in the country. We had the OBR here a couple of weeks ago, and they were pretty pessimistic about the long-term prospects for it. How concerned are you about the current levels of business investment, and what do you think needs to happen for it to recover?

Andrew Bailey: I will start, but I am sure others will come in. We have had very weak investment during the covid period and, indeed, in recent years. One important explanatory factor for that is very high levels of uncertainty. There is a reasonably well established relationship such that high levels of uncertainty tend to cause businesses to put off the decision to invest.

We actually have very strong investment in the forecast, for the first half of the forecast—in other words, next year and a bit beyond, but not into the second half—and there are two factors behind that. One is that we hope the covid-related uncertainty is going to be lifting. I should say, as a general observation, that it's interesting that covid actually has not been a large factor in the forecast that we have just done—for the first time.

The second thing is the fiscal policy measure—the capital allowance super deduction; we expect quite a strong boost to investment in the short term. After that, it is driven far more by the longer-term determinants of potential output. Again, we have done and published a report—one of our periodic stocktakes of that. It does return to some of the slower underlying levels at that point. I don't know whether you want to come in on that, Huw.

Dr Mann: I can come in on that.

Andrew Bailey: Catherine—yes.

Dr Mann: I do try to take a perspective from the business side of things, because, in my view, business investment is a driver of potential output—the long-term potential of the economy to grow—but also of demand. You need to buy things: machinery, equipment, IT and so forth. It is a factor that is really relevant to both the supply side and the demand side of the economy.

If we want to think about positives, positive drivers, certainly in the near term the super deduction is one of those, but also, information technology products have been an important driver of investment in the covid period as workers and firms try to figure out how to set themselves up for a hybrid workplace, so that has been a strong element.

Also, post covid or as we exit from covid, in the environment of a very strong labour market, firms search for ways of doing their business more effectively with the workers that they do have, recognising that it is very challenging to hire new ones. There is capital labour substitution as well as complementarity.

Those are important drivers of investment, so that is a tailwind for investment. On the other hand, the headwinds are very important. The uncertainty one we have already talked about, but there is also a headwind in what we think is the long-term demand for products. That is about the domestic side as well as the global side, and our forecast is for moderation in domestic demand as well as in sub-global demand. We have to recognise there are some headwinds coming from the trade barriers and trade administrative barriers. That also represents a headwind for broad-based business investment, because the global market is a very important component of businesses' strategy.

A third headwind has to do with the gap that we still see between the trend for GDP prior to covid and where we are now. We are back approximately to the growth rate prior to covid, but we are still 2% or so below where the trend was going—what we thought GDP was going to be, prior to covid. If you were a company five years or four years ago and you were estimating what investment you needed in order to satisfy demand, you would be looking at a situation right now where you say, "I don't really need to do any investment, because the demand is not going to be there, relative to what I thought it was going to be back, say, four years ago."

All that is sort of a negative in terms of business investment prospects, but there is a very strong potential driver of business investment that comes out of the energy transition.

If we think about a commitment to energy transition, of course, getting there is about commitment—it not just about monetary policy; it is a much broader Government policy commitment. If there is a commitment to a change in the relative price of carbon, we are talking about companies having to change their product process, the products themselves, and probably workplace practices along with that.

Those are the three elements that drive innovation and capital investment: change in product, change in process, and change in workplace practice. So, there is a pot of gold at the end of the energy transition rainbow—or getting there—that has to do with really driving a major change in business innovation and business investment. It is not something in which monetary policy has the major role to play, although we definitely do play some roles; it is much more fundamental. It is a very key game changer or a driver of business investment.

Q267 **Gareth Davies:** Thank you very much; that is a really good comprehensive overview of the long-term prospects for and risks to business investment.

Let me ask you, Huw, about the short term. Catherine mentioned the super deduction. Some have said that that is going to be more of a shot in the arm to move investment by time, not necessarily by volume. What is your view?

Huw Pill: It is, in part, intended to do that, and I think it will do that. Part of the reason, as Andrew has said, why we have a more optimistic view of investment in the near years of the forecast is precisely for that sort of substitution effect. Does that make it a problem? Of course, there are issues around smoothing that through time, but in terms of creating some momentum in a component of demand that has been lagging for the reasons that have been discussed, we certainly see evidence that we are headed in that direction.

Just to build on a couple of things that Catherine said, if you look at the information provided to us by the agents, which again, is reported at some length in the monetary policy report, there is a box describing this. They have asked their contacts what the outlook for investment is, and after a number of very barren years, we are now seeing quite a lot of positive views looking into next year, in part as uncertainty and so forth recedes, but also reflecting some of the aspects that Catherine described, including the climate transition story.

The super deduction is part of that, but I think if you look at least at what agents report from their contacts, it is not the only part of why we see investment picking up in the course of next year.

Q268 **Gareth Davies:** Okay; thank you. I want to move on to consumers. The OBR said in its session with us that our recovery will be a consumption-led one. In your report, you outline that part of the consumption—in the last quarter, it was up in some areas and down in others—is driven by household savings. I know that you have already mentioned it in this session, Governor, but can you explain a bit more about your assessment of household savings and how they are having an impact on your economic outlook?

Andrew Bailey: As I was saying earlier, we have seen quite a substantial build-up in household savings during the covid period—that is household savings in excess of what they would otherwise have been. As we have discussed in a number of past hearings, we have obviously then had a question of "What do we think is likely to be people's attitude and behaviour in terms of those savings?"

That is pretty hard to assess because there is not a lot of precedent for this—fortunately, we do not have pandemics too often in history. Going to the point I was making about the concentration of the savings, what we know is that they are concentrated among people who, in normal times, have a fairly low propensity to consume out of wealth; but these are not normal times, clearly, so that is only good as far as it goes, and it does not go very far.

From the evidence that we have been able to muster, which is partly using surveys asking people and partly using some other countries that are a bit ahead of us in terms of coming out of covid—New Zealand would be another point there—the evidence is that it is not a very aggressive run-off in savings. We made this assumption that only 10% of those savings are spent over the forecast period. I should say that, so far, we have not really seen evidence to call that into question at the moment, so we are stuck with that assumption.

Q269 **Gareth Davies:** I think I am out of time, so I will race ahead and ask you one last question, picking up on something that you just mentioned to my colleague. Is it safe to say—and are you saying—that we have now turned a corner and that covid is no longer the predominant factor in driving our economic outlook?

Andrew Bailey: Well, I'm not going to take any view on the health side of it, although I have said before that we talk to Chris Whitty as part of our forecast round, and he has been very helpful.

Q270 **Gareth Davies:** Covid is no longer the predominant driver.

Andrew Bailey: The economic impacts of covid have attenuated substantially over time. Going back to last spring, it was obviously having a massive effect on economic activity, but it has attenuated over time. Obviously, vaccinations have been a huge help in this respect, in terms of supporting economic activity.

Q271 **Gareth Davies:** So we have turned a corner and it is no longer a predominant driver.

Andrew Bailey: I hope so.

Q272 **Rushanara Ali:** Good afternoon. Yes, we live in hope.

My questions are about the international dimension and the UK's position. In your report, you say that "GDP growth is expected to be relatively subdued." By comparison with other G7 countries—Germany, Italy, France and the USA—the UK economy is behind on returning to pre-pandemic levels. We have talked about investment, some of the challenges around labour shortages, and the global dimension. What other factors are likely to impede the UK's recovery and catch-up with other G7 countries, and to what extent does fiscal policy impact on that recovery?

Andrew Bailey: We are all in a somewhat different place. Comparison with the US is helpful, and I might bring in Catherine at this point. The US has used fiscal policy extensively, and that has certainly had an effect in terms of the timing of the recovery and the timing of getting back to where we were pre-covid. That is a factor to be borne in mind. Catherine, do you want to come in on that point?

Dr Mann: Yes. It is about the magnitude of fiscal policy, as well as the tools used. If we compare the US and the euro areas—the UK is between the two of them—the US has a very large fiscal effort that is very much focused on giving consumers additional spending power. We see that dramatically across the global economy in the context of the goods prices that we have already talked about. The US achieved a pre-covid level of

GDP quite some time ago, but note that the labour market in the US has not yet returned to the pre-covid level. That is an important distinction.

The euro area deployed a smaller fiscal package but, more importantly, the fiscal packages were very much associated with help to businesses, particularly through guarantees, and with maintaining employment relationships. In some sense, there was not as much of an addition to the pocket book that would then show up in spending, and the euro area is not expected to return to the pre-covid level of GDP until some time next year.

Q273 **Rushanara Ali:** Thank you, Catherine, but can any of you explain why there is a difference between the UK and some of the other EU countries that I am referring to, such as Germany, Italy and France?

Michael Saunders: If I may, one issue—this is to get quite technical—is over the deflators for Government output. Looking at nominal GDP—in other words, not converted into real terms—there is actually not much difference between the UK and the major European countries in terms of the recovery compared with Q4 of 2019.

But in the UK, the GDP deflator—the price of GDP—has risen more strongly than in those other countries, and public services have shown weaker volume growth. Quite a lot of that is due to differences in the way in which public sector output is measured across countries. When you are considering the comparisons across the UK versus the EU, you have to allow a little bit for that.

Q274 **Rushanara Ali:** In terms of the response and going forward—you will probably say that it is not for you to answer, but I will try anyway—in terms of some of the changes that are coming in next year, such as national insurance contributions and so on, how much do you anticipate that the pressure on household income, alongside some of the other pressures on the cost of living, such as fuel and food prices, will have a knock-on effect on the wider economy and our ability to recover quickly? Or is it minimal?

Michael Saunders: The national insurance increase, as far as I understand it, is matched by increases in public spending, so the overall effect of that on GDP is really very small. It shifts around the composition of GDP, but it will not really affect the aggregate, and it is the aggregate on which we are most focused.

Dr Mann: A last point that I want to make is that there is an important difference—you were making a distinction between Germany and the UK—to do with the external current account balance or trade balance. There is a big difference there in terms of the strength of export demand between the two countries.

Q275 **Rushanara Ali:** I will come on to that. I will move to Huw Pill. The data released last week shows that the US has seen a 6.2% increase in the cost of living over the past year and that price pressures have broadened. Some senior Fed officials are now arguing that it is no longer transitory.

We have heard the word "transitory" being used a fair bit today. What is your view about whether UK inflation is transitory? Is there a debate going on about that, similarly to the US?

Huw Pill: Among the core reasons why we have seen a rise in inflation since the May *Monetary Policy Report* are, first, some base effects. Dropping out of the annual calculation are the very low rates of price increase that we saw in the immediate aftermath of the onset of the pandemic. That tells us more about what happened in 2020 than what is happening now, but it is important to see that there are basically two reasons why inflation is surprisingly upside.

One is closely related to what Catherine was just saying, namely that goods prices have risen significantly. Given that goods are generally internationally traded, we see that as a reasonably global phenomenon.

Why have they risen? I think it is a combination of the fact that there has been a continuation of the rotation of demand to buying goods at the expense of services—to give that a punchline, people bought flat screen TVs rather than going to the cinema, because of the covid situation—together with the disruptions to global supply chains. For example, there is still a zero covid type policy that is shutting down production in China, which is crucial to a whole set of global supply chains. That has boosted global prices of goods, and we are an importer of goods, so we are subject to inflationary drivers from that source.

Just to briefly repeat something that came up earlier, there is also the impact of higher global energy prices, which we are particularly associated with—

Q276 **Rushanara Ali:** Apologies. My question is, in summary, would you stick to the line that the inflation that the UK is facing is transitory rather than longer term?

Huw Pill: The point I would make is that those drivers are transitory, because we do not expect energy prices to continue at recent rates. We do think that the re-normalisation of patterns of demand after covid—to go back to the question, perhaps we will start going to the cinema and buying fewer flat screen TVs—will ease some of the disruptions to the global supply of goods, although perhaps more slowly than we would hope.

The key question, which is where we started this afternoon, is whether you create some so-called second-round effects—some impact on wage and price-setting behaviour coming from the higher inflation that we have seen. As we discussed earlier, our view remains that we will contain those second-round effects, through acting in an appropriate and timely way, and prevent the persistence.

Q277 **Rushanara Ali:** I am going to come back to the other panellists. In terms of the impact of the inflation in the US and given that bigger stimulus package, do you see any spill-over effect or impact on the UK economy, or any knock-on effects, beyond the transitory points you are talking about? Perhaps Catherine or Huw can answer that?

Huw Pill: I would just make the point, and then hand over to others, that there is no doubt that some of the momentum between the international demand for goods, which is part of the story I just told, has come from the fact that a lot of the US fiscal policy support, particularly to consumers—the stimulus cheques of last year—has been spent on internationally traded goods. That impetus to global demand is something we are experiencing through the impact on global goods prices.

Andrew Bailey: It is affecting shipping prices, for instance, because it is an internationally competitive industry. As Huw says, US consumer durables demand has been very strong. That feeds through into trade and Chinese output, for instance. Catherine, you may want to come in.

Dr Mann: I don't think I have anything to add on the trade side of things, but there is another channel through which very robust US growth and high inflation may affect the UK economy, which is the channel of international capital flows and cross-border interest rate adjustments. There is a global factor in policy rates, which tends to be driven by the Federal Reserve. The Federal Reserve tightens and that has spill-over effects on global economies and capital flows, therefore impacting the UK economy as well.

In the past, that channel has gone in the direction of the Fed first and then scrolled over to other economies, including the UK. I am not going to comment on what the Federal Reserve might or might or not do at their meetings, but it is certainly a factor that is relevant to consider as part of our own thought process with regard to the conduct of policy.

Q278 **Rushanara Ali:** I have two more questions for the Governor. In relation to the UK's disputes over the implementation of the Northern Ireland protocol, does that pose any risks to the economic outlook?

Andrew Bailey: It is not a risk that we have factored in. We follow it in terms of trying to work out what is going on, but it is not a risk that we have factored in explicitly.

Q279 **Rushanara Ali:** Do you think you should?

Andrew Bailey: We will keep a close watch on it, clearly. I am hoping—I am sure we all are—that this will be resolved one way or another. We are certainly watching it very closely.

Q280 **Rushanara Ali:** The OBR forecast, as a result of Brexit, a 4% hit, longer term, on productivity and GDP, and then a 2% covid impact. You have been looking at this over a number of years. What does this all amount to for the UK compared with other EU countries that are not in the position where they are primarily dealing with covid impacts and global supply chain issues, and likewise with the US? Where does that put us compared with other countries in terms of how we recover and our economic outlook, versus other countries? What should we be doing to make up for that? We have talked a lot about productivity and investment, but what would you say?

Andrew Bailey: On those two elements and numbers, then I will come back to the other point you have just made, we have not revisited the Brexit effect. As you know, we have talked in the past about the longer-term Brexit effects that we have in our own view.

Q281 **Rushanara Ali:** When will you be reassessing?

Andrew Bailey: I don't know yet for the reason I said earlier: at the moment, it is very hard to separate Brexit and covid.

Q282 **Rushanara Ali:** But the OBR seems to have been able to do it.

Andrew Bailey: I think they are also, if my memory is right, going to do a much larger piece of work at some point in the future.

Q283 **Rushanara Ali:** These are really big issues.

Andrew Bailey: But we just can't separate them. The data do not allow us to separate those two effects at the moment. They are having similar effects at the same time.

Q284 **Rushanara Ali:** Okay. Let's focus on what we do about those effects.

Andrew Bailey: On the scarring point you made, interestingly, the latest OBR forecast comes towards our number. It had a higher scarring number, and we were lower down, but I think the numbers are converging more now. It is getting increasingly difficult, though, to isolate the particular covid effect on scarring, because as time goes by there are other things, including the supply disruptions. At the moment, however, I think that with the 2% that you were quoting, those numbers are a lot closer than they probably were earlier this year.

A final point goes back to something important that Catherine said. If we think about the opportunities ahead, Catherine set out very clearly—something I agree with very much—that the sort of change that will be required if we are to get to the COP objectives will need a very substantial amount of investment. We can see that as a challenge, but we can also see it as a very big opportunity, as Catherine rightly said.

Q285 **Rushanara Ali:** Sorry to push you, Governor, but how do we fare compared with other countries that have not got this extra 4%? If we take the Bank of England figure, it is 3.25%, but the most recent figure is from the OBR, which is 4%. How does Britain fare given that we have that extra challenge? How do we recover from that?

Andrew Bailey: Certainly from what we can see at the moment—look at trade numbers—there is a somewhat bigger impact on UK trade over the past two years than there is for other countries. The biggest part of that, I should say, is imports from the EU; it is not so much exports to the EU—imports from the EU are the weakest of all. There has also been some effect on services trade, which we expected. To put my financial services hat on for a moment, it is not unsurprising that there has been some effect.

To comment on that part of trade for a moment, there is still an awful lot to play for on that front, and some things are working out in a sensible way, which suggests that we can co-operate productively in the future. I would single out the announcement that the EU made on clearing last week. I am saying nothing triumphalist—I do not believe that for a moment—but it was a sensible announcement. Of course, we would say that, wouldn't we, that we think we can work together co-operatively in everyone's interests, but I think—I hope—that is a sign that a constructive working together can emerge, certainly in that part of the economy.

Q286 **Rushanara Ali:** I have one final question for you, which is about vaccinations. We talked about China and the zero-covid point, but across Asia and Africa the vaccination rates are much lower. That is having a knock-on effect, so what steps need to be taken?

Andrew Bailey: It is.

Rushanara Ali: Where do we need to get to to reduce those sets of barriers caused by closures due to covid, lockdowns and so on in specific parts of the world economy? We have been talking about that since the pandemic began, and the concerns about global supply chains, and frankly that is coming home to roost—it is not like we were not aware of that this time last year even.

Andrew Bailey: Two things are running together here, and we have discussed both. One is that there is still concentration and demand for goods, which is increasing global trade pressures and shipping pressures—shipping costs. The other issue, as you rightly say, which compounds that, is the question about vaccination and responses to outbreaks of covid. For example, when Chinese ports get closed down, that has a direct effect. I am not, I am afraid, qualified to comment on Chinese vaccination policy—

Rushanara Ali: No need to. Chinese vaccination is less of an issue, but there are issues about supply to other parts of the world, which has an effect and which we have talked about for some months. The international community has not really addressed that fast enough, and it is having a knock-on effect on supply chains.

Andrew Bailey: What I will say is that it is a global public good that vaccination is widely done. It is for others to determine how that is done, but it is a global public good.

Chair: Rushanara, thank you. Finally, I call Alison.

Q287 **Alison Thewliss:** Thank you, Chair. I have some questions around monetary policy's role in net zero targets. Having had COP in my constituency, I am obviously quite keen that the agenda setting continues from there.

In the latest remit letter from the Chancellor, the MPC's secondary economic policy objective includes support for "transition to an environmentally sustainable and resilient net zero economy". In your view, is that something that monetary policy can do and, if so, how?

Andrew Bailey: Monetary policy can make a contribution. The Bank of England has got quite a few irons in the fire, as it were, and interests in this, and they go beyond monetary policy, but let me just talk about monetary policy—well, the broader part of monetary policy.

There are two parts to that. One is that we announced just over a week ago our policy towards the corporate bond portfolio that we hold. We have been doing a review during the course of this year on how we want to, in a sense, use that policy towards that portfolio to incentivise change.

It is very much a policy of incentives. Building on the work that is being done more broadly, because we are involved in it, we are particularly encouraged by the announcement on international disclosure standards that was made in Glasgow. And building on that, the future choices we make on investment in that portfolio will be incentivised towards firms that are meeting climate targets and we will, as we put it, tilt our investment decisions in that direction. Also, we will not be making coal investments; they will not feature in the investments going forwards. All those are consistent. They are not diverging from the monetary policy purpose of this portfolio; we think they are consistent with managing it in a way that is consistent with setting incentives.

I should just add on that issue that we get asked from time to time, "Well, why don't you just sell the bad investments?" My answer to that is, "I don't think that would help, because I'm afraid they would end up in the hands of people who would want to exploit them, and sweat the assets." It is not a very big portfolio; it is about 6% of the sterling corporate bond market. But I hope that we can use it to create incentives that others will then follow.

The second thing, which relates to what Catherine was saying, is that a lot more needs to be done on what I call the macroeconomic scenarios of climate change. We have done a huge amount of work in that field; I'd like to say that we are somewhat world leaders in that field, working with other central banks. But there is a lot more to do on that front.

Climate is now coming right into the monetary policy horizon. In times gone by, I think some monetary policy experts would say, "No, it's over our horizon. We're not in that business"; indeed, we were doing far more of it in the financial stability supervision world, which has a longer horizon. But you can't say that any more.

I think a bit of what we are seeing in energy prices at the moment has a link to climate considerations, so we need to do more in terms of those scenarios. The Monetary Policy Committee had its first discussion of that two or three months ago. It will feature much more on our agenda going forwards.

Q288 **Alison Thewliss:** Thank you; that is very interesting. I am glad to see that you included coal. Will you be looking at other fossil fuels in that as well?

Andrew Bailey: With the tilting process, yes, in terms of tilting to get those whose bonds we own to meet both the intermediate test—2025—and the net zero test. Yes, we will come through in that way.

Q289 **Alison Thewliss:** Okay. You talked about the disclosure standards, the data, and so on. How can you be sure that the committee is getting the right data to make the right decisions?

Andrew Bailey: That will be important internationally. We are just setting off down this road. There has been agreement to set up the new financial reporting standard, the governance and the board behind it, and I am very pleased that we've got agreement on that; a huge amount of work has gone into it. I can also say, wearing a different hat, that the global Financial Stability Board will have a role in overseeing the implementation of that; for my sins, I have just been appointed chair of the committee for that job. It has to be done globally, because we cannot do our own thing on this front.

Q290 **Alison Thewliss:** Thank you. Would some of your colleagues like to come in? Dr Mann, you were talking earlier about the impact of innovation on net zero. Speaking from your role on the committee, what more do you see being part of that?

Dr Mann: There are two comments. One is on the extent to which the central banks and regulators have been working together for some time. There is a base of co-operation already there. Now that we have the disclosure standards, they can be applied more globally through the regulated entities that are in place.

When it comes to the disclosure standards, and the role of the central banks and the regulatory community, it is important to keep in mind that ultimately we want to set up a strategy that will incentivise the private sector, because no amount of Government money will get us to the transition. This has to be incentivised in the private sector. The best way to do that in a co-ordinated way is through the bodies that have been created, and have been working together for some time on standards that are global, so that we create a level playing field and move the investment community forward—the financial investment community as well as the private business investment community. They have been working together towards this goal.

Michael Saunders: Another thing the Bank is doing, through the decision maker panel—it is a very wide survey that we do—is trying to understand better the extent to which climate change objectives are driving firms' investment choices. We published the latest DMP survey a couple of weeks ago, I think. There, you will see a chart or two showing how these issues are affecting firms' investment choices now. By finding that out from companies—by shedding light on it—you are better able to pick up on firms that are slower. You can engage in conversations with them—you can say, "This is what your competitors are doing; what about you?". That helps to create an environment in which that becomes an integral part of firms' planning.

Q291 **Alison Thewliss:** That is interesting. To what extent do you think that is part of the planning at the moment, from what you have found?

Michael Saunders: The DMP survey suggests that there is a fairly widespread and, on balance, positive effect on firms' investment choices. Having talked to firms, I have to say that over the past few years, there has been a massive change in their attitudes to this. It was a relatively peripheral issue; now, most firms and sectors are grappling with it.

Dr Mann: One of the other panellists was concerned about the UK relative to other economies. I think the European Investment Bank has a survey of firms that asks similar questions to those asked by the decision maker panel. We now have information about how firms in European economies are reacting to the prospects for climate transition. The US economy is included in the EIBIS survey, as is the UK. There is quite a bit of information to bring to bear on this.

Q292 **Alison Thewliss:** I will certainly look at that in more detail. Is there any evidence that people are doing what the Governor suggested they should not do—withdrawing all their money from coal-based industries? Or are they investing in transitioning away, and in moving to newer types of technology?

Michael Saunders: My impression—I do not know whether others have a different view—is that firms are investing to transition.

Q293 **Alison Thewliss:** That is interesting. Progress on the greening framework is subject to the CBPS maintaining its primary monetary policy purpose. Are you satisfied that it will do so?

Andrew Bailey: We are not changing the size of it; it is its make-up that will be affected. All this is conditional on the fact that the Monetary Policy Committee can, at any point in time, take a decision on the future of the portfolio. We have not taken the decision. We have taken a decision on what we will do about the gilt portfolio, which is much bigger; this is very small by comparison. We have not taken a decision on the corporate bond portfolio. We have been very clear, from a monetary policy perspective, that any policy we have on the greening side will not override the Monetary Policy Committee's ability, at any point in time, to take a decision on what it wants to do about the portfolio, in terms of whether we have it or not.

Q294 **Alison Thewliss:** Has the Bank made an estimate of the impact of the greening framework on the borrowing costs of firms?

Andrew Bailey: No. That is an interesting one. It would not really fit into the Monetary Policy Committee's remit. I would be happy to write back on that. It is an interesting question, and I can get our climate people to have a think about it.

Q295 **Alison Thewliss:** Okay; that is grand. Sorry, Huw, I have not brought you in. Is there anything you want to add on the impact of COP on the work of the MPC?

Huw Pill: The only thing I would add to what Andrew said is that we will be looking to see. We have only just started on the greening, so it is natural to try to assess what impact it has on pricing. That is a difficult question, but a natural one.

Dr Mann: There is information in the markets more generally about the relative borrowing costs of green bonds versus regular bonds. It created an attractive environment for those borrowing more generally, because of the demand from the investment community for ESG-type bonds, so it has been beneficial to those companies issuing green-oriented bonds.

Alison Thewliss: Thank you very much.

Chair: Thanks, Alison. That brings us to the end, so I thank our witnesses very much for appearing before us, particularly Huw and Catherine, whose first appearance it was; we look forward to seeing you on many other occasions.

It strikes me that the big word hanging over all the grappling for answers today is "uncertainty"—there is much uncertainty in the economy. The good news is that there will be answers to all these essay questions in time, and we will have you back for future sessions, when we will be able to discuss them with you.

Andrew Bailey: But with more questions!

Alison Thewliss: There are always more questions.

Chair: Thank you very much indeed for attending today. That concludes the session.