HOUSE OF COMMONS

ORAL EVIDENCE

TAKEN BEFORE THE

TREASURY COMMITTEE

QUANTITATIVE EASING

TUESDAY 14 MAY 2013

KATE BARKER CBE and DR ANDREW SENTANCE CBE

Evidence heard in Public Questions 187 - 278

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Oral Evidence

Taken before the Treasury Committee

on Tuesday 14 May 2013

Members present:

Mr Andrew Tyrie (Chair)
Mark Garnier
Stewart Hosie
Andrea Leadsom
Mr Andrew Love
Mr Pat McFadden
Mr Brooks Newmark
Jesse Norman
Teresa Pearce
John Thurso

Examination of Witnesses

Witnesses: **Kate Barker CBE**, External Member, Monetary Policy Committee, 2001-10, and **Dr Andrew Sentance CBE**, External Member, MPC, 2006-11, gave evidence.

Q187 Chair: Thank you very much for coming to give evidence this morning. I am particularly grateful to both of you, because I know that in different ways it has been problematic for your diaries. You are leading experts on this subject and it is extremely valuable to have the benefit of your advice and views. May I begin with you, Mr Sentance? You have told us that there is a risk of a negative shock for the economy from emergency monetary policy; what shock did you have in mind?

Dr Sentance: When I have said things like that, it is more about the exit from emergency monetary policies. The longer we go on with very low interest rates and a large injection of quantitative easing, the more people adjust to that situation, and therefore the beginning of an exit from those policies could be quite a significant shock. In my view, the exit from what I would call emergency monetary policies, or extremely lose monetary policies, needs to be planned and phased over a period of time to avoid that shock.

Q188 Chair: Have you seen the evidence of Gavyn Davies, Stephen King and Roger Farmer to this Committee?

Dr Sentance: Yes.

Q189 Chair: Is there anything that they said—any major points—with which you disagree? In particular, do you disagree with their view that the benefits outweigh the costs at the moment?

Dr Sentance: No, I am not sure I do agree with that view, taking the quantitative easing that we have seen as a whole. I would make a distinction between the quantitative easing we did in 2009 and subsequent quantitative easing. I think the quantitative easing that we did in 2009 and carried on into very early 2010, which I supported—I voted for every pound of it—when I was a member of the committee, was a necessary response to a very difficult economic situation, following the collapse of Lehman's, the financial crisis and the deepening recession in late 2008 to 2009. It was part of a package of measures that stabilised the economy and then provided the basis for some, albeit modest, recovery that we have seen since then. I did not support the QE that was done by the MPC after I left, in 2011 and 2012, and I do not think, necessarily, that it was justified. It did not turn out, if you look at the impact on the economy, to have a very noticeable effect on growth. It has compounded the problem of exiting from QE, because we now have twice the value of Government bonds sitting in the vaults of the Bank of England that we had at the end of the first round of QE.

There is a difference in what happened in 2011 and 2012. I went back to a speech that I remembered from Charlie Bean in early 2011. He drew a distinction between QE as an emergency response to a very difficult situation, where it may have an impact on turning round the tide of confidence in financial markets, and QE as a routine tool of monetary policy. In 2011 and 2012, the MPC was trying to use it too much as a routine tool of monetary policy, and it was not necessarily effective.

Q190 Chair: We will come on to the unwinding of QE later in the session. There are Treasury questions at 11.30 am, and some Members may need to drift off. We may run on a little longer if a sufficient number of colleagues are interested, and we may get on to unwinding then, toward the end of the session. Kate Barker, do you disagree with anything that you have just heard from Andrew Sentance? Do you agree with the witnesses we had before us the other day?

Kate Barker: I know that you do not want to talk about unwinding yet, but, briefly, for what it is worth, I agree that the first stage of unwinding will, potentially, present a bit of a shock to the economy. Therefore, I am sure it is something that the MPC, at the time, will want to approach very cautiously, just as, indeed, the first stage of moving away from the 0.5% bank rate is going to be a bit of a shock and will have to be done cautiously.

In terms of the overall costs and benefits, I was very conscious during the time that I was on the MPC, and at the time of the crisis, that we were in a much more difficult period for policy, where the balance of risks between different courses of action was much harder to weigh up. I would agree that, at the time we started QE, the balance of evidence was that the benefits almost certainly outweighed the costs. The original rounds of QE had very big effects on confidence. It is clear that they helped to push up asset prices and that the markets at the time were really relatively dysfunctional.

I agree with the view that now, when confidence is generally better—it is not great, but it is not as depressed as it was in early 2009—and when markets are generally functioning better, it is not likely that QE will have such big effects. Nevertheless, if we think of this crisis as something we are learning we will have to manage our way away from very slowly, the advantage of keeping growth going now to help with the fiscal situation and the advantage of having slightly higher inflation now to help with debt deleveraging are really quite important advantages.

I do not disagree that there are costs—there are clearly distributional costs, and there are clearly risks if asset prices get pushed up too far—but I, too, would tend to agree with Gavyn and Roger Farmer, and say that, at the moment, I still think the benefits outweigh the costs, but in a much less significant way. QE has become much less powerful, and that is part of my general feeling that monetary policy, on its own, cannot do very much now to change the course of this economy.

Q191 Chair: So it is diminishing returns—more coats of paint, of the same colour, on the same wall?

Kate Barker: Yes.

Q192 Jesse Norman: Kate Barker, without regard to the transitional costs of moving to a different set of interest rates, do you think we currently have optimal interest rates in this country?

Kate Barker: Do I think they are optimal now?

Jesse Norman: Yes.

Kate Barker: I find that quite a hard question to answer. I was on the committee when we voted for 0.5%, and it would be odd for me to say that I do not think it is the right rate, as I am not sure there has been a great opportunity to increase rates since. But I am prepared to share with the Committee the fact that, at the time the vote was taken, I was among the members who were slightly reluctant to go as far down as 0.5%, partly because of the well-known strains, which I know have been discussed here, that it puts on particular financial institutions that had unfloored tracker mortgages—what is sometimes, in my view, misdescribed as the building society problem. There were some worries that this was in principle a very low rate. However, it is not really clear to me that it has been amazingly damaging compared with, say, leaving the rate at 0.75% or 1%, so on the whole it probably was just about the right decision. Were I still on the committee, however, I am reasonably confident that I would not be in favour of reducing the bank rate further.

Q193 Jesse Norman: Right, but that does not really quite address the worry that you hear expressed, which is that even if QE at the moment is the best of an unfortunate set of alternatives, it is having the effect of slowing down or suspending the business cycle and therefore suspending the normal processes by which an economy repairs itself.

Kate Barker: I am familiar with that argument. I can see in a way that there is something in this concern, but this comes down to the big question of how we want to manage our way through. If you think back to where we were ahead of this crisis, and the way in which people had formed their expectations of growth and real income over the five years following the crisis, it is absolutely apparent that the departure from that path has been very significant, and that much of that will not be got back. We have had a huge shock to all the plans and intentions that lay behind where the economy stood in 2007. You could manage out of that by saying, "Okay, there is a big adjustment to be had. We'll have it all really quickly. We'll have lots of people out of work with all the long-term damage that does. It would have probably been even more difficult to manage fiscal policy, because you would have had an even deeper recession, but we will come out of it clean, and in x years' time, maybe the growth rate will be better."

Or you can choose to do what we have done and manage our way through it in a way that has been less painful in the short term but may prove to be very protracted. I find it pretty difficult, frankly, to guess which of those two, when we look back in 10 years' time, we will feel turned out to be the right answer. I would not wish to be in the situation of some European countries now, with incredibly high unemployment, particularly youth unemployment, and all the political difficulties and tensions that brings about. Although I do not disagree that the price we are paying is that we have these so-called zombie firms, and we have perhaps not done as much to clean up the banking system as we would wish, I do not think, "God, I really wish we had gone for the hard exit", because we might have regretted that very bitterly.

Q194 Jesse Norman: Yes. Dr Sentance, do you want to comment on that? My question was whether interest rates were at their economically best level, without regard to the politics. Politics would be a separate question about how one manages or considers unemployment. Do you think that interest rates are at their economically optimal level now?

Dr Sentance: It is something that is very difficult to gauge. I believe that back in late 2010 and early 2011, the committee should have been trying to make some effort to move interest rates away from such a low level, which is, after all, not just the lowest level we have had in the recent period, but much lower than we had even in the great depression in the 1930s. When we put in place those interest rates—it is interesting to go back to what was believed at the time—the belief was that this would be quite a short phase of very low interest rates, and the market expectation for interest rates was that they would come back up. By now, the expectation in mid-2009 was that we would be up to interest rates of about 3% to 4%. Clearly, that would be very aggressive tightening, and I would not have supported that, but we are in a situation where there will not be an ideal time to move away from 0.5% rates.

The growth of the economy is going to be difficult for some time, not predominantly due to monetary policy, but due to the structural factors that are holding back growth—what I call the new normal for growth, not just in the UK but in other western economies as well. I would like to see central banks, not just in the UK but in the western economies, begin to prepare the ground for a gradual rise in interest rates—not back to the level we had before the crisis, but getting away from what I would describe as emergency levels of interest rates—and in a sense accustoming the public and the business and financial community to the fact that that is a sensible and normal response to trying to get the economy functioning a bit better as we come out of the financial crisis.

Q195 Jesse Norman: A final question: there could be serious long-term consequences to having a completely flat yield curve, could there not?

Dr Sentance: There are potentially quite serious long-term adverse consequences of having a very prolonged period of ultra-loose monetary policy. If expectations build up that it is going to remain ultra-loose for a very long period of time, that tends to flatten the yield curve. There is a whole host of reasons why that may be undesirable. Bill White, ex-BIS, has talked quite a lot about this.

Q196 Chair: Kate Barker, you raised not one but I think both eyebrows at one point in those exchanges.

Kate Barker: I can't raise them one at a time, I'm afraid.

Chair: Perhaps you would like to tell us why. This is with respect to the economically optimal level, as opposed to the politically optimal level.

Kate Barker: I was slightly surprised at the distinction that was being drawn between economics and politics, particularly with regard to unemployment. Unemployment seems to me to be politically undesirable; bluntly, in the short term, it is also pretty economically undesirable, because of the decay of skills. In any case, I have always thought, as a matter of fact, that one's credibility as a monetary policy maker—this comes back to the issue about growth and inflation, which I am sure you have discussed—rests not just on whether you hit the inflation target, but on whether you hit it in a way that shows sensitivity to the long-run needs of the economy, and, indeed, people generally. If that is not a concern to you, you really should not be on the committee.

Q197 Jesse Norman: To be clear, I was not advocating any of the positions that are implied by that. I was raising the question of whether or not a policy that is notionally targeted on a series of economic outcomes, including growth, might want to take a different view, or at least acknowledge some tension between those two. You are suggesting it should not, because you are not prepared to allow a distinction between what might be economically optimal rates and the political reasons that might shape those rates.

Kate Barker: It depends what you mean by politics. I was raising my eyebrows, really, at the idea that unemployment is political, as I always think of it as economic. It is not that I do not think there is a distinction sometimes between decisions that are politically convenient and economically right.

Q198 Mr Newmark: I want to say one thing before going on to the international comparisons, just as an observation; if you want to comment on it, you can. We have historically low interest rates; we have £750 billion-plus on corporate balance sheets; and there are a lot of people out there with cash in their pockets, so it is not really driving down interest rates that is going to do it—it is confidence. There is a lack of confidence among both consumers and corporations today. The Catch-22 we are in is that until they start getting confidence—seeing a little bit of growth back in the economy, and a little bit of asset inflation with their houses and so on—they are not really going to start spending money, no matter where you drive interest rates to. That is my observation from talking to people. Would you like to comment on that?

Kate Barker: Is that a question?

Mr Newmark: It is a rhetorical question, but would you like to answer it?

Dr Sentance: I agree that there has been a big shock to confidence. We have moved out of the world where the economy seemed to be on a path of steady growth and low inflation, and we have seen both weak growth and high inflation. Trying to design a set of policies that would try to help rebuild that confidence is quite difficult. In my view, the notion that we are coming out of the financial crisis and are putting some of the problems behind us is quite important to building confidence. Actually, a central bank that is talking about, and perhaps acting and starting to move towards, exiting these emergency monetary policies could be a part of that, but that needs to be part of a broader policy package. I also think that supply-side measures that help business and help the economy function better can also be good in rebuilding confidence, and can give businesses that desire to invest a bit more. There is possibly a whole package of measures that you could take to try to build confidence.

Q199 Mr Newmark: There is obviously some positive news, because lots of new businesses are being set up—there are about 250,000—and there is the productivity conundrum, in that we have record high employment, with more men and women in work than ever before. There is obviously some positive news there, but it is this general confidence issue that negates the continual driving down of those interest rates, which I do not think is necessarily the answer. That brings me to my next point: the race to the bottom in the currency war going on at the moment. Is there a risk that central bank quantitative easing programmes make a currency war more likely? We see the US, the UK, the Europeans and Japan all printing more and more money; ultimately, they are each effectively debasing their currencies, but everything becomes a relative game then.

Kate Barker: Yes, I cannot do anything other than agree with that. In some sense, when we began the programme of quantitative easing, one way in which we said it would work was through a lower exchange rate. It is noticeable that the Monetary Policy Committee has been pretty clear recently that it is not necessarily seeking a lower currency today, but I think that if you were sitting here in a few months' time and sterling had risen quite strongly, that might well be one of the factors that would cause people to think about restarting quantitative easing.

I do not disagree with either of your propositions. I already made the point that interest rate policy is pretty ineffective at this point in the cycle, and I would agree that people have become very concerned about their currencies and have gone back to a concern about devaluation, which was actually something that we had moved away from, so it is slightly surprising that it has come back as such a policy panacea.

Q200 Mr Newmark: Is this something that the MPC was discussing at the time that QE was initiated?

Kate Barker: Yes, as I say, we talked about the exchange rate as one of the transmission mechanisms for quantitative easing. Of course, we had already seen sterling weaker by then, because at the time the judgment was that the UK's banking system was worse than everybody else's; it has turned out that the European system was not quite as sound as they expected.

Q201 Mr Newmark: As an outsider, I observe that having started a process where you wanted to drive down interest rates and effectively drive down our currency to make it more competitive, that really has not done the trick, in terms of stimulating growth.

Kate Barker: No, it has not done the trick, and it has not done it for two reasons. The first is that, of course, the European economies have turned out to be much weaker than we thought at the time. Nevertheless, I have to say that if we had not done it and our currency was still stronger—this is the argument economists often make about not knowing the counterfactual—it is possible that growth would have been even weaker than it has been.

Q202 Mr Newmark: Are you saying that, in the absence of the collapse in the euro area, the strategy would have worked, and we might have seen a little bit more growth stimulated?

Kate Barker: I am saying both that the strategy would have worked better, and that, had sterling been up against the euro area, our exporters might have found life even more difficult than they have. I want to make the further point that it is also true that when we started our QE—you see this again in the minutes of the March '09 meeting—we talked about the fact that even though sterling was weak, we did not expect much of an inflation push from that, because demand in the UK was so weak. Of course, the inflation push from weak sterling turned out to be rather larger than we expected; we put too much weight on the experience of the '92 devaluation, which caused very little inflation. The devaluation we had in 2008-09 turned out to cause rather more inflation than the MPC anticipated.

Dr Sentance: I take a slightly different view on sterling. It was quite right in late '08 and '09 for the committee to welcome a weaker sterling as being of help to maintain competitiveness and ease some of the pressures in the economy. As time went on, I got more concerned that actually we were seeing the negatives from a depreciation of the currency, in terms of inflation, but we were not seeing enough of the positives.

Aside from the things that Kate mentioned to do with the weakness of the euro area economies, as I went around on the MPC visiting companies, I visited British manufacturers. The manufacturers that make up the British manufacturing industry are quite high-tech and specialised; they operate in niche markets and are not very price sensitive, so they are not necessarily going to be priced into markets by a more competitive currency. I felt that—I said this in my last year on the committee—the committee should have been trying to strike a better balance. Yes, we perhaps wanted to acknowledge that we needed some boost to competitiveness, moving from where we were before the financial crisis, but we also needed to take into account the impact of a weaker currency on inflation. In some ways, that actually squeezed growth, because the inflation choked off some of the consumer growth that we might have seen had we not had such high inflation.

Q203 Mr Newmark: I appreciate that other people want to ask questions, so there are two other areas that I want to touch on briefly: first, an area where it seems to have worked, which is the US, and secondly, an area where perhaps it has not worked, which is Japan. If we look at the US, the Fed's version of QE involved purchasing a wider range of assets than the Bank of England. Should the UK be adopting the same approach: should we be looking for a wider asset purchase programme?

Dr Sentance: As I did not support doing more QE after 2009, I would not have supported buying those assets.

Q204 Mr Newmark: Well, QE as we were doing it here was simply printing money to buy back our own debt. In the US it is slightly different: they are going for a wider range of schemes.

Dr Sentance: I am not sure that accounts for the difference between US and UK economic performance. Stephen King made the point when he came before this Committee that there are less private sector assets that we could have easily bought. However, I think that when we first did the QE in 2009, it was quite experimental. We had not done something like that before, so we did the straightforward thing, which was to buy Government bonds—we also bought some corporate bonds; there was a corporate bond element to the programme, but it was quite small—but you did see other financial markets respond to that, so you could say that there was a knock-on beneficial impact on other financial markets as a result. If you look at the US economy, their growth has not actually been that spectacular by their historic comparisons. They are getting unemployment down, but growth is only around about 2%, which is low by historic comparisons.

Q205 Mr Newmark: But there is an argument—I speak to my friends in the States—that the bubble that we have seen in the Dow, and maybe a bit in the FTSE, is to do with the amount of extra cash in the system. When we look at the stock market, it can be done purely on expectations about how business and the economy are doing. I would love to be able to say that is what it is—that we are coming out of the hole, everything is going great and we have the FTSE and the Dow at a record high. Or we could be asking whether part of the pricing that has gone into the Dow and the FTSE has been driven by QE.

Dr Sentance: At the global level, it is quite likely that the amount of liquidity that has been pumped in—through the United States, what Japan is now doing and what the UK did—and the combined impact of the interest rate cuts that we have seen, across the western world in particular, is all contributing to the current financial climate. It is pushing up asset and equity values in a way that I am not sure is going to be sustainable in the longer term. In other words, if there was a readjustment of monetary policy, we may see some correction away from that.

If you look at the performance of the US economy more generally, I think that, historically, it has always had perhaps a bit more bouncebackability—to borrow a football term—than the European economies.

Q206 Mr Newmark: Because it is a more diverse economy; it is less reliant on the financial services sector.

Dr Sentance: Yes, it is more diverse and more flexible. There are a lot of entrepreneurial firms and there is a strong culture of entrepreneurship. The fact that the US economy is doing a bit better now is as much a product of that as it is to do with policies.

Q207 Mr Newmark: Before I speak to Kate I want to touch on Japan with you. What is it about Japanese QE that has not worked?

Dr Sentance: They tried it in the early 2000s. You can think of a variety of reasons why it did not work. It appeared a little half-hearted from the Bank of Japan; they were not believed to be very confident that it was a policy that they saw as very effective. It was not on the scale that we have seen subsequently in western economies. The other factor was the length of time that elapsed between the start of the Japanese financial problems and when they got around to doing QE, which was about 10 years. Whereas, when we came to take the decision, I felt that it was very important that we built on the momentum that we had achieved by cutting interest rates and showing that the Bank was pulling out all the stops, so we moved straight from relaxing monetary policy in a conventional way to unconventional monetary policies with quantitative easing. That helped to boost the confidence impact and the impact that we got in the financial markets, rather than waiting for a period and seeing what happened. We got more bang for our buck out of the first phase of QE by doing that.

Q208 Mr Newmark: Kate, what do you think about US versus Japan and lessons learned for the UK?

Kate Barker: I agree completely with Andrew's answer on Japan, but it is a useful corrective. In some ways, one of the things we think about QE is that it might have worked better had there been a stronger global economy, but Japan struggled with QE during periods when the global economy was pretty strong and it still did not have an effect. That suggests to me that there is something uncomfortable—the US managed to get out of it a little better—in trying to deal with balance sheet recessions. This comes back to the point you made at the beginning that it is not likely that monetary policy on its own will be able to get us out of this quickly, and we should not think that it can.

Q209 Stewart Hosie: Paul McCulley and Zoltan Pozsar argued in a recent Global Interdependence Center paper that in a liquidity trap the central bank's role changes to one of helping government "borrow and invest by targeting to keep long-term interest rates low by monetizing debt". That is effectively what some people argue QE is. They do that "with the aim of killing the…risks of deflation and depression." To what extent do you agree we are in a liquidity trap now and to what extent do you agree with their assessment of what QE is?

Dr Sentance: I took a look at their paper and I am not sure I fully agree with their analysis, for a number of reasons. One is that it seems to me that if you make the shift, as they are suggesting, of moving away from the Bank pursuing its conventional role of price stability and being independent in doing that, you have to re-accumulate credibility at some future point. If you have a regime shift, as they are suggesting, I am not sure that it is easy to reverse and re-establish that independent price stability role of the Bank when you need it.

To some extent, looking back over the period of the financial crisis, particularly in the context of the UK, fears of deflation were perhaps, in hindsight, slightly overstated. We have actually had not deflation, but rather persistent above-target inflation. They are suggesting some extreme and radical changes to fight off deflation, but we have done that within our existing structure. It comes back to Kate's point. Some people are expecting monetary policy to do more than it realistically can do in this environment. If there are structural and supply-side reasons why growth is weak in western economies such as the UK, which I believe there are, trying to push even harder with monetary policy is not necessarily the right approach. It risks creating further financial imbalances and running a higher rate of inflation than you would ideally like.

Q210 Stewart Hosie: Let me come back to some of those points. In terms of the basic assessment, they describe the liquidity trap as a situation where the asset prices collapse, where the credit bubble bursts, where there is damage to business balance sheets and where there is massive de-leveraging with a reduced demand for credit. That is pretty much what we have seen over a period of time. They argue that in those circumstances, conventional monetary policy alone does not really do very much, hence this, as you described it, emergency monetary policy of QE. Is the description of the liquidity trap accurate, before we even move to what has happened next in terms of QE?

Dr Sentance: The liquidity trap has a long history and people interpret it in different ways. I go back to your comments about those asset market movements and financial movements. I think that in 2009, through deploying the conventional monetary policy framework, where the MPC was acting as an independent central bank and responding to the forecasts that were in front of it, we did head off some potentially quite negative outcomes. In terms of the first round of QE, I think we were able to do a lot of what you are describing and avoid the worst scenarios of going into deflation. We then found ourselves in a much more complicated world. I am not sure I would purely characterise it in terms of a liquidity trap; I would characterise it as a world in which the drivers that were underpinning growth before 2007 have gone away to a large extent, and in which all major western economies are struggling to achieve the sorts of growth rates they would like. In that environment there is a limit to what monetary policy can do, so taking more extreme monetary policy is not necessarily the right way to go.

Q211 Stewart Hosie: You describe the central bank as having to have the regime shifted. I suppose more generally we can argue that in those circumstances it was more a case of co-ordination between monetary and fiscal policy. Where do you think we are in terms of the co-ordination between monetary and fiscal policy in the authorities in the UK at the moment?

Dr Sentance: If you look at the thrust of the policy statements that the Government, the Governor and other members of the MPC have made, there is a view that in order to accompany a tightening of fiscal policy and a reduction of the deficit we need to keep monetary policy relatively loose, which should not necessarily compromise the Bank's inflation target objective. I do not disagree with that proposition in general, but what is relatively loose monetary policy in the current environment? Does it mean 0.5% interest rates, having injected quite a bit of additional QE over the last year? That was, to my mind, a more appropriate policy for the situation in 2009 than for where we are now. The difficult judgment that central banks are having to make is where to pitch their monetary policy. It clearly needs to be looser than it was before the financial crisis, when we had interest rates of about 5% or so. But I am not convinced that keeping the same monetary stance into the future that we set in 2009, and certainly not doing additional QE on top, is the right way to go in these circumstances.

Q212 Stewart Hosie: I appreciate that. I am trying to get to the structural issues, rather than the consequences of the policy. Let me ask both of you, can we ever have a situation where there is co-ordination such as we are seeing—it is described by the Government as monetary loosening and fiscal tightening simultaneously—where the central bank effectively loses its independence? And is that a good thing or a bad thing, given the circumstances?

Kate Barker: I have not managed to track down this paper over the weekend, I'm afraid, so I have not read it and I am reliant on your and Andrew's descriptions of it. I have to say that I agree strongly with the basic proposition that in normal circumstances we think of fiscal policy as dealing with the micro-conditions of the economy—tax and that kind of thing—and setting a long-term, steady course, which forms a background to the economy against which monetary policy operates to manage demand around what is thought of as the output gap. Once you have moved into this kind of crisis, you have gone away from that model completely into a situation in which it is much more important that we see the monetary and fiscal sides working more explicitly together. It has become more complicated because the Bank is not just doing straightforward monetary policy. It is also doing financial policy and managing the banks' balance sheets.

What is important for the Bank and the MPC is their independence to set monetary policy a little tighter than the Government would like, if they are worried about inflation. That seems to me very important, and something that should not be abandoned. Beyond that, personally I think the more co-ordination the better. I am made somewhat uneasy by the fact that in the Budget the Chancellor talked about fiscal tightness and monetary loosening; the Governor then pointed out—and I agree with the Governor here—that there is not much more that monetary policy can do, and we have to think about fiscal policy. A bit later we have the Chancellor writing to the FPC in terms that suggest he does not think that they are putting enough weight on short-term growth. Bluntly, I think all this is quite unhelpful. As you probably know, one thing that I am anxious about in the present circumstances is that there is no proper co-ordination between things that are being done at the Bank—I am talking about more than monetary policy—and the decisions the Chancellor is taking. That disturbs me about the present situation, which I think does call for co-ordination.

We need to have some sense of a route map of how we are going to get through this really very difficult and prolonged quagmire, how much risk we want to take on today to boost short-term growth, because we think that is so important for the long term, and when we think that might be going a bit far. All route maps of course will need changing and adjusting as you go along, but if you do not even start with a co-ordinated view and some ability to continue to have good co-ordinated discussions on it, I do not see how we will get the right balance.

Q213 Stewart Hosie: That is a fascinating assessment. Digressing completely from the script, given that Mark Carney has now effectively been given flexible inflation targeting, and the signalling effect of the direction of travel, in terms of interest rates and inflation, is in place, will that help in terms of co-ordination in the way you would like to see?

Kate Barker: I am not sure really that when I read Mark Carney's evidence I thought he was going to be any more flexible than the MPC has already been. The MPC has been very flexible in accommodating inflation, although I would make another point, which is that the inflation we have just had has mostly been imported inflation. It has not been very useful for getting the level of debt down. We have had very little domestic inflation. Indeed, the MPC sounded terribly worried that any resurgence of domestic inflation might call about a reaction. Perhaps his tone there will be a little bit more helpful, because if we are going to warn against every resurgence of domestic inflation, that too might not help with growth. I do not think that he is talking about being much more flexible, because with many of the things he talks about, such as looking over a longer time period to bring inflation back to target, bluntly, the MPC was already doing it.

Q214 Stewart Hosie: A final question: Stephen King, the chief economist at HSBC, commented that "Central bankers are making decisions"—this is the discussion we have just had—"that are more political than economic." Did he overstate that or is it right?

Kate Barker: Is that what he was saying? Basically, what is political and what is economic? Central banks are certainly making decisions that they believe to be in the best interests of the economy. One of the difficulties, and of course you have had plenty of evidence on this, is that because of the nature of these decisions, they have turned out to have quite difficult and prolonged effects on the balance of interests, for example between savers and borrowers. As we see the FPC come into being, it is asked to do things such as decide whether to phase out the second stage of the help to buy scheme that is being introduced. Those decisions too may come to be seen as having slightly more political overtones, and that too can be awkward. Indeed, I think in a speech Carney made some years ago, he argued against central banks being given too many things to do in case it undermined their credibility over the big thing they have to do, which is deliver us sound money in the long run.

Q215 Chair: Do you think the Government are attempting to in any way compromise, or they may have the effect of in any way compromising, the independence of the FPC with the introduction of what they purport to call a remit letter, the decisions they have taken on appointments with the FPC and their decision to delay passing control over the leverage ratio to the FPC?

Kate Barker: I do not personally think that the change to the remit letter will turn out to be terribly significant. I know that it enables the Chancellor to comment on the balance between growth and inflation, but my personal experience on the MPC is that we were always very alive to the need to think about that and to get it right. We were never inflation nutters in that sense. We always had a concern about growth, because we always understood the points I have already made about hysteresis and about smoothing the path of growth. I would be surprised if this turned out to be very different; it might turn out to be different, but my judgment is that it would not.

The second point about the FPC is different from the independence of the MPC. I do not think that it undermines the independence of the MPC. I suggest that perhaps there are some uncertainties around the FPC itself, but that is a different question.

Q216 Chair: Well, answer the different question.

Kate Barker: The combination of the changes in appointment and the tone of the document that the Chancellor wrote suggested to me that he was uneasy about some of the things that the FPC had done before. But, to be blunt, the things that happen at the Bank happen under Government Acts; the Government sets the framework, and, within that, decisions are taken independently. The FPC, after all, is rather feeling its way; arguably, it did not have a clear statement of purpose—the Government may not have quite known, when it set the FPC up, exactly what it wanted to do, and we are feeling our way towards that. I think the MPC was different: it was very clear what was wanted and, by and large, the overall remit has stuck, and actions have been taken independently.

Q217 Chair: Some have put it to me privately that, as far as the FPC is concerned, the Government are getting their retaliation in first.

Kate Barker: This is the FPC?

Chair: Yes.

Kate Barker: I could not comment on that.

Dr Sentance: Let me comment on the MPC remit. The practice of what the MPC does probably has not changed very much in substance, although it has been made quite complex, and where there is complexity, it can breed a bit of uncertainty about how the MPC is going to act. Some oddities have crept in. For example, when there is an explanatory letter from the Governor to the Chancellor about inflation going away from target, that letter will not arrive until after the next inflation figure is already out in the public domain, because it has to wait for a meeting of the MPC and for the minutes of that meeting to be produced. One of the weaknesses I thought there was in the MPC framework was that this letter exchange did not appear to be very meaningful; it was the Governor writing an explanation, and the Chancellor saying, "Yes, that's fine." One thing that could be beneficial would be if these letter exchanges were more meaningful, although I am not sure that is the direction we are heading.

Chair: Why don't you pen us a meaningful specimen on one side of a piece of paper so that we can see what one might look like?

Q218 Mr McFadden: I want to keep going on this theme because you both have a lot of MPC experience. I want to continue on the remit and the Chancellor's announcement in the Budget about the change to it. From what you are saying, Kate Barker, would I be right in saying that you think this is not really much of a change and these balances between growth and inflation have always been considered by the MPC, so we should not read much into the changes the Chancellor announced? Is that your view?

Kate Barker: I think that is broadly right. The change is that, in the letter-writing, the Chancellor explicitly says he might comment on whether he is happy with the way the balance is being struck. That opens up the opportunity for some sign of disagreement, which we previously did not have. But frankly, I have to say that I cannot think of any time on the MPC when we were not acutely aware of the second part of our remit and of the need to smooth if inflation got out of track in either direction. Particularly after the crisis—I hope I have been clear on this—one of the reasons we were prepared to do QE, and the reason the MPC was prepared to carry on doing QE even when the recorded inflation rate was high, was precisely because of this worry about keeping short-term growth going. It may be that a different MPC and a different Governor had a view such that it was necessary to write that letter, but on the whole, I would have thought that reasonable people taking reasonable judgments about the speed of getting inflation back to target would probably not need to be told very often that they have not got the balance on growth correct.

Q219 Mr McFadden: Is that your view as well, Dr Sentance?

Dr Sentance: One thing that seems to have got a little lost in this discussion about inflation and growth is the notion that, ultimately, monetary policy cannot fundamentally change the medium-term growth path of the economy. It is about taking sensible short-term judgments, as Kate describes, and not trying to drive inflation back to the target in a very aggressive way, if that is going to disrupt the economy. I think that makes a lot of sense.

Q220 Mr McFadden: I am asking a simpler question, which is whether what the Chancellor announced is really a change, or signals a real change, in what the MPC has been doing.

Dr Sentance: I think we will only find out as we see the MPC operating under this new remit. The minutes from the MPC suggest that the MPC does not feel that there have been fundamental changes. It seems to me to be trying to put into the remit something a bit closer to the way the MPC has been behaving. We will find out over time.

Q221 Mr McFadden: The stated remit is catching up with practice rather than the other way round.

Dr Sentance: My worry is that with this change to the remit it will be quite complex and trying almost to cover lots of contingencies and different situations. I suppose I would prefer that the remit had been kept a little simpler. We have the letter exchanges, and the Chancellor can always make observations or comments about what the MPC is doing if he feels that it is not striking the right judgment.

Q222 Mr McFadden: You said your preference might have been for a simpler remit. You also said there are limits to what monetary policy can do to generate growth. Do you think perhaps that in making too much of this change in remit there is a danger of an inflation of expectations around what the Bank can do, which could result in disappointment?

Dr Sentance: I think there is a danger of expecting the Bank to do too much in the current circumstances. The Monetary Policy Committee reduced interest rates to 0.5%, kept them there much longer than we envisaged when we made that move, and injected £375 billion of QE, which is about a third of the Government debt. It has co-operated with other initiatives like the funding for lending scheme. We have pushed the levers of monetary policy quite a long way in the direction of stimulus. Economic analysis tells you that monetary policy can do a certain amount for growth in the shorter term, but it is not there fundamentally to change the medium-term growth path of the economy. It is probably not capable of doing that. Four or five years on from the financial crisis, we may have to recognise that we need to adjust our horizons about what sort of growth the UK economy can deliver in this current environment, a concept I have referred to as the new normal for growth, which is different from the sort of growth rates we were accustomed to before the financial crisis.

Q223 Mr McFadden: So your advice to the Chancellor and the new Governor would be, “Don’t make too much of this new remit because you are at the limits of what your policy can do anyway.”

Dr Sentance: I would not put it quite like that. I would say that you have to be realistic about what monetary policy can do to support the growth of the economy—it is doing quite a lot already—and recognise that in the medium term, price stability and keeping control of inflation is the overriding objective and that still remains the case. That is a very important feature of our system.

Q224 Mr McFadden: Slightly on this theme of focus on the main job, when Gavyn Davies gave evidence to the Committee last week, he warned about the dangers of overloading central banks with too many tasks. He mentioned up to six that central banks are being asked to do: target inflation, growth, unemployment, the health of the financial system, and "sometimes the exchange rate, and now they are clearly being asked to target the funding costs of the banking system. The list is going on and on." Do you share his fears that central banks are being overloaded with too many conflicting tasks that could distract their focus from the main one of monetary stability?

Dr Sentance: I think there is a risk of that. Certainly, if you go back to the position before the financial crisis, there was a much simpler set of responsibilities. I would be concerned on two counts. One is that there is a lack of clarity and potential conflict between some of these objectives, and therefore the Bank might take its eye off the ball in important respects; but also, there is a managerial aspect to this, which is that the UK central bank in particular has got quite a lot of increased responsibilities, and it needs to have a management structure whereby it can cope with those. In my view, this should require the Deputy Governors being much more active and visible in the roles that they are overseeing. That is one of the managerial challenges, I think, the new Governor faces.

Kate Barker: I disagree with Andrew on one point, which is a return to a simpler system. I think we were frankly unduly simplistic in our approach to monetary policy in the run-up to the crisis, because we did not pay—it is pretty clear, now, really—sufficient attention to financial imbalances; I do not think that was helpful. I think inevitably decisions taken on monetary policy are complex, and it is right, in a way, to be reminded of it.

The second thing I wanted to say was about the remit. I agreed, clearly, with the general points about growth. But in today's particular circumstance, if monetary policy could get growth going in the short term, because you would avoid hysteresis, this is one of the times it does have the opportunity to affect medium-term growth. Unfortunately, I do not think it is capable of doing it.

The proposal to move towards thresholds may turn out to be something that has an impact on the economy. I am not terribly optimistic about it, but I think—this rather goes against the tone of the earlier discussion—that a set of approaches announcing thresholds for when you might consider changing the bank rate, and that made it clear to people that bank rate would stay low for a certain period, might turn out to be helpful; but I think we should not delude ourselves that it will get us out of this mess quickly.

Q225 Mr McFadden: In some of these discussions, do you think there is a danger of people like us getting too wound up about the boundaries between fiscal and monetary policy? After all, what is wrong with the Chancellor—any Chancellor—trying to use any lever that they have, be it fiscal or monetary, to generate growth when you have not had any for three years? I doubt if my Wolverhampton constituents would be bothered, if they could get some decent economic growth and higher employment, whether the result had been driven by fiscal or monetary policy. Why should we be worried about all this?

Kate Barker: In the end, the reason why they should be worried about it is sort of one of the answers that Andrew gave: if something that happens today takes away from the credibility of our long-run inflation control in the UK, that can be very costly, because we know how very difficult it was to get that back in the past; so anything that says, "Actually, we are not going to let the Bank do what it really feels it needs to do to maintain inflation credibility" I would see as a bad thing, and carrying quite a high cost.

If the benefit, on the other hand, of faster growth today was sufficient, you might decide you wanted to bear the cost of slightly higher inflation today; but that would be a very big judgment to make. I am not arguing that today, by the way; I am just saying that I do not think it is completely impossible. Actually, the committee itself ought to be able to think about that a little bit, and in a way, as I say, it has already been pushing at inflation credibility in pursuit of growth—it still maintains quite a lot of inflation credibility. I think that is about right.

Otherwise, some of the other worries that come up around central bank independence I rather agree with you on. In the end, the central bank is there as part of the apparatus of government. It is charged with taking some things independently, because we think politicians take decisions too much for the short term, but it is there, ultimately, for the good of the UK. It is not there for the good of the central bank.

Q226 Mr McFadden: I will give the last word to Dr Sentance. Are we close to questioning the credibility that Kate Barker spoke about, given that inflation has been above target for the last few years anyway?

Dr Sentance: I have been concerned for some time that the way in which the MPC has responded to the situation that it has faced with disappointing growth, but also above-target inflation, has appeared to accommodate and tolerate higher inflation, which has costs, not just in the longer term, but in the short term.

Q227 Mr McFadden: It is quite clear about why it did that.

Dr Sentance: There is a lot of talk about looking through inflation spikes, but then there is always another one to look through. I think that the perception of how keen the Bank of England is to keep inflation at the target and approximating to price stability has changed as a result of the experience we have had. At some point, maybe, the Bank would need to flex its muscles and re-establish its credibility.

Q228 Chair: You said earlier, Andrew Sentance, that one should not allow monetary policy to be thought of as something that can raise the long-run growth rate, which means that you have a list of things that you think might raise the long-run growth rate. Do you? You do not have to come out with them now; just tell me whether you have a list.

Dr Sentance: Yes. Things such as tax reform, easing the burden of business regulation, sensible infrastructure developments, and so on.

Q229 Chair: Would you prepared to give us a short note outlining the headings that you think should be looked at?

Dr Sentance: I would be very happy to do that.

Chair: That would be extremely interesting.

Q230 Mark Garnier: We were talking a few seconds ago about the Bank of England target for inflation. Why 2%? Why not 3% or 1%?

Dr Sentance: It is a very difficult judgment to strike. When I was on the committee, I felt that with the 2% target, if you kept inflation at about that level, it was inflation that was sufficiently low that it was not really noticeable to the general public, and you could see that in terms of the media coverage. When we were achieving 2% inflation, there were not, by and large, stories about inflation in the press. There was a general perception that some prices were going down and some were going up by a bit more than that, and this was something that the public saw as broadly stable. Once we saw inflation going up, as we did on two occasions, to 4% or 5%, there was a noticeable difference in people's perceptions of inflation.

That was having a much bigger impact—a noticeable impact. I thought that was an enlightening and revealing exposure of why perhaps 2% is roughly a reasonable thing to head for.

Q231 Mark Garnier: It is a very finger-in-the-air sort of thing, isn't it? Someone came along with a bit of work looking at the correlation between inflation rates and growth rates, and I think that the higher growth rates came with inflation at 3.1%. It seems that there is no sort of science behind it, though I know that economics does not have any science.

Dr Sentance: I think it is very much to do with credibility. You have to set a benchmark somewhere. As Kate and I have observed, the MPC has been relatively flexible in allowing inflation to move around from that. One view could be that price stability means just that—0% inflation—but people have, by and large, not gone down that route because they think that you are in danger of lapsing too easily into deflation. There is a balanced judgment to make, but I think that 2% is a reasonable place to nail your colours to the mast.

Q232 Mark Garnier: Is it more to do with having a predictable level of inflation rate, rather than having cyclical levels in which you go up to 5% and down to 0%? You do not have to answer this question in any depth, but it is very interesting that we have this random target that has been missed for about five years.

Dr Sentance: On the upside, I think that over the period that it has been missed, there has been a much wider public perception of, and dissatisfaction with, inflation as an economic problem.

Q233 Mark Garnier: To drag ourselves back to the QE question, do you think QE has had an influence on this, or do you think it has been to do with other factors?

Dr Sentance: I think that QE has raised inflation above what it would otherwise have been. That is not my judgment; it is the judgment of the Bank's analysis, which it published in 2011, which said that the peak impact of the first £200 billion of QE was to raise the inflation rate, after a period, by about 0.75% to 1.5%—it was not very precise. I think there are three main channels through which QE would have raised inflation. One is that when the economy turned around in 2010, although we did not recognise it perhaps enough at the time, demand was growing reasonably healthily in nominal terms, and that created an environment in which companies could push through price increase more readily, after a squeeze in the recession. Secondly, there is the role of the exchange rate. I believe that QE has created a lower value of exchange rate than we would otherwise have seen. Thirdly, there is the impact on expectations. It is striking to me that if you decompose the CPI into goods and services, services inflation since 1997 has been fairly consistent at about 3.5% to 4%—fluctuating around that level—which suggests that in that part of the economy, perhaps the expectation is that price increases can be pushed through more easily. I think that QE—the willingness of the Bank to inject money and to support the economy—has probably reinforced that view.

Q234 Mark Garnier: Interesting. A lot of people, at the beginning of the QE process, were arguing that not only would it be inflationary, but it could lead to hyper-inflation. Clearly, when one assesses what is going on in the economy, one has to look at the various risks that we are facing. One of those risks, potentially, is inflation, and I am interested in your thoughts on this. It strikes me that there are two risks where inflation and, therefore, an increase in interest rates could come about. One of them is if the economy starts to perk up and we start to see reasonably healthy growth, and there may be a desire to keep things slightly under control with rising interest rates. The other is if we start seeing the importing of inflation, because of our low currency.

What interests me is that you have argued that the MPC should consider a gradual increase in rates by 2% to 3% over the next two or three years. I am very curious about why you think it is possible to predict, two to three years in advance, how you can increase interest rates so predictably. I completely appreciate why that is desirable, but I cannot see how you can get to the point where it is predictable how it will go up, given that so many different things can have an effect on why interest rates should go up.

Chair: When you have answered that question, I will bring in Andy Love very quickly, because he is going to Treasury questions afterwards.

Dr Sentance: I will make it a short answer.

Mark Garnier: But a good answer.

Dr Sentance: The reason for advancing that proposal—I would not tie myself too much to the exact numbers and time period—is that it seemed to me odd that the notion that the monetary policy that we set in the depths of the financial crisis, at 0.5%, is now regarded as a sort of neutral benchmark, whereby if the MPC meets and decides that it does not want to do anything, it keeps it at that level. I think some mechanism needs to be found—whether or not my mechanism is the right one—of re-benchmarking what is a neutral monetary policy as we come further away from the financial crisis and come through the problems that we have experienced. If the MPC was prepared to follow my proposal and set a gradually rising interest rate as what it would expect if the economy is on a reasonable track—you could qualify that in all sorts of different ways—that does not stop it deviating from that if something unfortunate happens, or we get another bout of the euro crisis.

What I am really trying to argue is that we need to re-benchmark. When we are moving up from a very low interest rate, we cannot just leave it to the point at which we say, “We will do that when the time is right.” It might appear that the time is never quite right, and the circumstances in which we would have raised interest rates before the crisis do not reoccur, so we need to re-identify what that neutral benchmark is.

Q235 Mr Love: I want to come back to a point that Kate made about thresholds. Mark Carney is intimately associated with this forward guidance idea. If I may say so, you have rather discounted it as being effective. I just wondered, Dr Sentance, how you look on the idea of forward guidance and whether you think it has any merit at all. Kate, perhaps you could give me a more detailed assessment of how you think that might help.

Kate Barker: I am happy to do that. In a sense, Andrew has just given us an example of his views on forward guidance, and I think that mine are rather different.

I take it that the argument for forward guidance is that people are somewhat uncertain—here, I have some sympathy with Andrew—about the conditions under which the Monetary Policy Committee would want to move away from the present low Bank Rate. They are unsure, in the jargon, about what the reaction function of the committee is. In some ways, having forward guidance that is not, “They will put rates up in two years”, but that says, “These are the conditions that would be sufficient, but not maybe necessary, for us to start thinking about putting rates up” will help to give people some security that rates are not going to be raised tomorrow. That would be perfectly sensible and could be effective, if I looked at the yield curve and thought that people were terribly worried about rates going up before they needed to, but I do not get that feeling today. It might actually turn out to be effective not so much while we are still in this period of very low rates, but if it gives some clarity about the pace of tightening.

Here, again, I think possibly disagree with Andrew, because I think the pace of any tightening coming out of this particular situation might—nothing is certain—have to be rather gradual. I would be rather reluctant to give the idea that once we start there will be a quick pace. That might be quite undesirable, and could expose us to shocks to the system in a way that we are all worried about, when we come out of it. There may be some value in it. I suppose the reason that I do not think it would be enormously useful comes back to the big point that has come up several times, which is that nobody thinks monetary policy today is terribly powerful; further adjustments to it may be of some use, but they are not going to change the weather somehow.

Q236 Mr Love: I suspect I probably know the answer you are going to give, Dr Sentance, so maybe this is better focused at Kate Barker. There is the example of the United States, where they are undertaking further QE on the basis that they are waiting for certain things to happen, which supposedly QE will give. Given the circumstances the UK is in, do you see any merit in a policy similar to that pursued by the Federal Reserve?

Dr Sentance: The difficulty with these thresholds is that you end up tying yourself to one particular economic indicator; for example, the US is focused on the unemployment rate. When you are looking at the way in which the real economy is evolving, and how it bears on the MPC's task of price stability and keeping stable financial conditions, I always worry about putting too much emphasis on one indicator. One indicator that gets a lot of excessive weight these days is GDP, when the estimates that we look at get changed quite frequently. You could say some things about the sort of path for GDP you might expect, but if the data were revised, you might look as if you had made a mistake. I must admit that I am quite uncertain about whether these threshold-type approaches can really be made to work in a way that means that you can give very clear guidance on what you would do in all circumstances. There are always going to be some circumstances that perhaps you have not thought of. For me, the jury is out on how useful it will really turn out to be.

Q237 John Thurso: Can I come back to what you both said at the very outset? Dr Sentance, you talked about one of the great risks being the exit, and I think you said much the same thing, Kate; I will just ask some questions around that. When the MPC was first considering QE, right at the outset, was any consideration given to how to get out at the end, or was the approach simply taking a leap in the dark, and "Who cares where we're going?"

Kate Barker: I would not say that it was taking a leap in the dark, but—I know this has often come up in this Committee, when you have been talking about events around the financial crisis—it is important to remember the very severe fear, anxiety and day-to-day worry that we were all under during the crisis. It would be truthful to say that the key thing we were trying to do was improve confidence and asset markets at that time, because the problem that loomed before us seemed so vast. We were aware that there might be some other problem when it came to unwinding it, but quite frankly that was not at the top of our minds.

Quite soon after that, and certainly while I was still on the MPC—I left in 2010, and I do not know whether there was any discussion subsequently—there was some discussion about how we would tackle moving away from monetary easing. The view at the time was that the first tool we would look for in tightening would be movements in the bank rate, because they were judged to be of more certain effect, although I should say that they are not of totally certain effect. The idea was that, as you moved into a more normal state, the QE might be unwound gradually, kind of in the background to the tightening. The quantity of QE that has been done now suggests that it would be possibly unwound over quite a long period, although that would depend on circumstances. There would need to be discussions with the

Debt Management Office, so that it knew which kinds of gilts were going to come back on to the market and could set its strategy. We were aware that it would be complex, but I do not think that we thought it would be impossible to achieve. I do not know whether there were subsequent discussions. Andrew?

Dr Sentance: No, the discussion that Kate refers to underpins some comments that the Governor put in his 2010 Mansion House speech; I think that you can find a paragraph in the speech that shows that that was the feeling at that time. Looking back, I am surprised that we have kept with the monetary policies that we put in place in 2009 for so long. At that time, if you looked at market expectations, they were that interest rates would have gone up before now and, as Kate said, we thought subsequently that that environment would be one in which you would unwind at least some of the quantitative easing.

In March 2009, the main concern was to make sure that what we did was transparent and clear. There was a separate asset fund where the QE bonds were kept, so that when we did unwind the policy at some point in the future, it would be all very clear how that was progressing.

Q238 John Thurso: If I can encapsulate what you said, bearing in mind the problems of 2009, which we all remember, the fact was that QE was seen as a tool that was certainly worth trying and that most people thought would be beneficial. Even looking back now, most people believe that that first hit of QE was a very useful tool to deploy, even if there is argument about its later deployments. Therefore, it was more important to do the job than to worry about how you might reverse out in due course. We can park that as probably how everybody, broadly, feels.

We are now hopefully coming closer to the time when the exit will be before us and more thought needs to be given to that. Kate, you mentioned that the bank rate would probably be the first tool to be used. In achieving future monetary policy, what do you think is the relationship between the bank rate tool and the reversal of QE? In other words, are we saying that the existence of QE is outwith the norm, that the bank rate will therefore be the norm, and that getting rid of QE is actually a question of removing it gradually, without doing too much harm? Or are we saying that we now have a second tool in the locker, and it is therefore an equally robust intellectual argument to discuss how much you use the reversal of QE to do the job that you might have used the bank rate for, if that had been all that you had?

Kate Barker: To some extent, this turns on whether you think QE is just a substitute for the bank rate. There are certainly some people who argue that it is just a substitute for the bank rate, although the transmission mechanism is not quite the same; the effects on the yield curve may be a little bit different from the effect that a changing bank rate has on the yield curve. I think that, on the whole, the way in which you described it—the bank rate as your primary tool, and the unwinding of QE as something that you do in a rather gradual way—is the way in which the Bank was thinking about it at the time that I left. I have no knowledge as to what subsequent internal thinking has been on that, but the speeches I have seen on it suggest that that is still the basic course of action.

I would say that it would presumably depend a little bit on the circumstances at the time—what the yield curve was doing, and how much Government borrowing was still being done—and that is correct. It must be right to think that they do have slightly different implications, and therefore that you might want to think about the pace of unwinding QE, but on the whole I would have thought that, in terms of the gilts market, it would be better to try to do it in a relatively predictable fashion, so that it is not jerked around by unexpected movements in QE on the way out.

Dr Sentance: I agree with Kate's assessment there: it does depend very much on the circumstances. You could envisage a circumstance—I do not think it is likely—where the economy becomes a lot hotter, and the MPC wants to move quite quickly. Then, it may be thinking about the withdrawal of QE as an active instrument operating alongside interest rates. I think the more likely scenario is the first one you outlined, with interest rates gradually moving upwards and QE gradually beginning to be unwound in the background.

Q239 John Thurso: Going back to your earlier comments about re-benchmarking our expectation of interest rates, a considerable number of negatives flow from low interest rates in a number of areas, in the markets and for individuals. In a situation where the economy is growing with a degree of robustness, it is actually quite a good idea to get back to something more normal right across the board; it is not a good idea, I assume, to keep interest rates at their current low level—it is not a particularly good thing.

Dr Sentance: I agree with that argument. When you reduce interest rates very dramatically, as we did in 2009, you do not necessarily see the adverse of very low interest rates, because the people who are affected negatively perhaps do not adjust and expect interest rates to go back up again. These negative impacts of a very low level of interest rates come with a period of time; savers start adjusting their behaviour, and people start taking more negative views.

Q240 John Thurso: If you look at the amount of money that is held in savings, by pensions and so forth, and if you look at a combination of circumstances where you have low interest rates, the impact of QE and all the rest, you actually have a situation where quite a large chunk of the potential consumers in the economy have suppressed income. If we get back to something more normal, and we start to see more normal interest rates, that will release that income to some degree and therefore give a boost to consumption. Is that an argument you think has merit?

Dr Sentance: In an environment where you are gradually raising interest rates, there is very much a swings-and-roundabouts effect. Yes, there will be some borrowers who find that they are having to pay more, and who perhaps respond by cutting back on consumption to some degree, but there is a large constituency out there whose consumption may benefit, and who may take some confidence from the notion that we are going back to a more reasonable level of interest rates. These are issues that, I hope, will be recognised by the Monetary Policy Committee in its discussions.

Q241 John Thurso: The strong steer I am getting—this is what I was really leading you towards—is that it is really quite important, all things being equal, that the bank rate rises before there is an attempt to get rid of, or to lower, QE, because lowering QE becomes a blunt instrument, which may actually suppress growth too much, so it is better to use interest rates first.

Kate Barker: If you are raising rates, it must be because, in some sense, you want the economy to slow down. That would actually suggest you would have to raise the bank rate more before it had any traction.

I omitted to say earlier, when I was asked whether I thought 0.5% was a good rate, that one reason I was concerned about it was that once you got below 1%, we did not have much knowledge as to whether lower rates were positive or negative for the economy as a whole, and I still hold to that. Therefore, symmetrically, I ought to believe that going back to 1% will not necessarily have much effect in holding the economy back. Indeed, were we able to go back to 1%, and if I did not think it would have any effect on interest rate expectations, I might think of it as a measure that was not particularly contractionary.

When you are getting to the point where you think, for inflation-control reasons, which is why you are taking these decisions, that we really need to tighten a little bit, you would not move the bank rate first because you thought it would be positive; you would want to say, "What's the best way to achieve a contraction?" I would still move the bank rate first, I think, because I am more confident of its effects. Also, if we are doing this at a time when there is still an awful lot of Government borrowing going on, you might not want to disrupt the gilt market by having very big adjustments in unwinding QE. That would be my rationale.

Q242 John Thurso: You lead me neatly into my last question, which is about the danger of inflation. If, as many have argued, there is a potential within the exercise of QE for stored future inflation—as the economy starts to return to normal and inflationary pressures return, they will be amplified by what has happened in QE; there will be a delayed aftershock, as it were—it may be necessary to start to reverse QE in some measure in order to have that inflation suppressant. To what extent do you think, first, that there is the potential for that inflation problem, and secondly, that it will be necessary to start an exit plan to deal with it?

Kate Barker: You are raising the possibility that the money multiplier from QE, which has of course been very low, suddenly becomes much bigger. My feeling is that that would be associated with a period in which the economy looked a heck of a lot stronger, in which case it may very well be that you would want to withdraw QE slightly faster. My general reply to that would be that I would really love to be on the committee when it has that problem.

John Thurso: Be careful what you wish for.

Dr Sentance: Another circumstance that you may envisage is if the pound is falling and you have some degree of impetus to inflation from that direction, and you want to restore confidence. I could see the committee perhaps acting a bit more quickly in that sort of scenario. All these scenarios are very difficult to envisage. I suppose I am somewhat suspicious that the sort of circumstance in which we changed interest rates before the financial crisis will re-emerge; hence the committee needs to start thinking about the challenge more strategically, rather than just as something that it will do when the right time seems to emerge.

Q243 John Thurso: When we started, you both highlighted "What we do next? Where is the exit?" as the key worry. The message that I am getting is to think about it, strategically if possible, but to be prepared to react to whatever the different circumstances are.

Dr Sentance: If I have a concern about some of the communications from the Bank and the MPC recently, it is that they have not really attempted to alert the public and the business community that at some point we are going to need to move away from this period of very low interest rates. We should gradually be raising awareness of that, so that it does not come as a big shock, and so that people factor it into their planning for the future.

Q244 Chair: You do not think that putting that out now will depress confidence?

Dr Sentance: It is something that you have to handle quite sensitively and carefully, but not talking about it at all would not necessarily be my response.

Q245 Chair: You are going to jot something down for us so that we can have a look, aren't you, Dr Sentance?

Dr Sentance: Yes, absolutely.

Q246 Chair: All on one side of a piece of paper. Kate Barker, do you agree or disagree with this forward-signalling point?

Kate Barker: Of course, it is very counter to the forward-signalling point that we think Mark Carney may produce if he moves to forward guidance.

Q247 Chair: That was the point that I was edging towards.

Kate Barker: I do not disagree with the proposition that people who borrow today, particularly on floating rates, should know that, if they borrow on floating rates for a mortgage over a long time, at some point in that period rates may well go up. Fortunately, the specifications of the mortgage market review are such that that reminder will be given to people at the time they take out the loan. That is quite important. I would hope that businesses do not think rates will stay at 0.5% for ever, and that they too will think about that when they structure and deal with their borrowings. I do not disagree with the idea that people should be reminded that the rates will not be here for ever; whether I want to alarm them into thinking that they are going to move tomorrow is another matter, although I do not think that is what Andrew was suggesting.

Q248 Chair: And you are happy with the Carney signalling that is going on?

Kate Barker: I am happy with it being considered; I am dubious as to whether it will make an enormous difference. Like Andrew, I should add that the idea that you should have one measure by which you judge whether you are going to move rates seems a bit odd. I am sure that you would have to have a bunch of measures, which means that inevitably it will not be quite as clear and easy to grasp as one might like.

Q249 Chair: You agree that there is a risk of a contradiction between the Carney signal and the Sentance signal?

Kate Barker: Absolutely, yes.

Q250 Chair: Do you want a rejoinder on that point, Dr Sentance?

Dr Sentance: What you are alluding to is the fact that a lot of the talk about this forward guidance has been in the context of keeping interest rates low until something happens. The point that I am flagging is that there is also a medium-term challenge out there that will presumably emerge some time during Mark Carney's governorship.

Q251 John Thurso: May I quickly follow up what you were saying? On low interest rates, to most SMEs they are not anywhere near as low. In fact, Ana Botin told me yesterday that the average cost to an SME is from 5% to 8%; it is 6% or 7%. That corresponds with what all the other banks are saying; it is somewhere between 5% and 8% for a decent SME loan. That is, of course, based on a margin over. The danger, surely, is that we are all thinking in macro-economic terms about 0.5% going up to 1% or 2% eventually. These loans are already up at 7% and they have seen quite big moves up. There is now a complete disconnect between the bank rate and the actual effective rate for a business.

Dr Sentance: We will find out only when rates start to move exactly how that spread and margin moves. It may be that not all rates will go up together. I think it is quite likely that they will not.

Kate Barker: I think that is a very useful corrective to the idea that most people do not know rates will stay low. Very few people are borrowing at very low rates, though some fixed-term mortgages are now at much lower rates than they have been. Yes, SMEs are borrowing higher up, and I imagine they still feel rather uncertain about what will happen.

Q252 Andrea Leadsom: To follow up on that point, it has certainly been argued by the banks that the reason for that big differential between base rate and what SMEs can borrow at is the real-world truth that you cannot run a business on 0.5%, and therefore the margin is an actual amount of money, as opposed to a margin. That seems to me a reasonable assumption. As base rate goes lower, you still require a certain amount of money to be able to run your business, even though as a bank you might be borrowing at a very cheap rate price on a long-term fixed-rate basis, for example.

Is there the scope, and would it be straying too far into fiscal territory for the MPC, for example, to be talking about increasing base rate, but at the same time urging banks not to respond immediately? Obviously, there is a huge differential right now between those who have got a fixed-rate mortgage at perhaps 2%, 3% or 4%, and those who are on floating rates, who are hoping that what they are currently paying 3% or 4% for is not going to rocket suddenly.

In the real world, quite apart from the theoretical macro-economic world, there is a real disparity between what the banks are likely to do if base rate ticks up a bit, and what we would need them to do in the economy, which is to hold their rates and simply absorb those very small increases. Is that the job of the MPC or the job of politics? Who should be doing that?

Kate Barker: I have to say that I do not think it is the job of the MPC—I would say that strongly—to say what the banks should do. The MPC would wish to take into account, when it is judging how far to put up bank rates, what it thinks the transmission mechanism will be. Certainly, during the time I was on the committee, one of the things we always looked at was how far any change we had made to the bank rate had been passed through into a whole variety of interest rates.

I should declare an interest, as I am a non-executive director of a building society. One of the things that I am sure all lenders are acutely aware of is that the people who have been borrowing on standard variable rates are often among the most exposed of our borrowers. Of course, when we finally see a bank rate change and have to look at our book, you would expect that to be taken into account, but I am not sure that the Government trying to affect it would be particularly useful, in a sense, at that stage.

Q253 Andrea Leadsom: But I am asking who should be doing that. Clearly, somebody should be doing that.

Kate Barker: Can I make another point? You say somebody should be doing it. If we are raising the bank rate, we are doing it because we want to slow the economy down. If we offset every ill effect of it, frankly, we won’t achieve that. I agree that the lenders have to give some thought. Nobody wants suddenly to raise their standard variable rate hugely and find that lots of people come into bad loans, because that is enormously costly. Of course, you will be thinking about that and trying to judge the risk. It is not clear to me that the Government are better placed to do that than the lenders.

Dr Sentance: I take a little bit of issue with what Kate said about raising interest rates because we want to slow down the economy. I think there are circumstances in which you may be raising interest rates in that environment, but there is this medium-term strategic challenge. I am not sure, as we do not really know what it is like moving interest rates around at this very low level, what the balance of swings and roundabouts would be between savers and borrowers, and how it would play out. I think the MPC would have to feel its way a bit, taking into account some of the things that you are talking about. If the financial health of the banks is improving and has improved—we had some reasonably good reports recently—it makes it easier for the banks to accept that the margin would gradually diminish over time, which I think is the effect that you are looking for.

Q254 Andrea Leadsom: Exactly. That is precisely it. The point is that base rate is at 0.5%, which is very different from when it is at, say, 8% and you are thinking about moving it to 7.5%. When it is at 0.5%, nobody really knows whether it is making a huge difference to the economy or not, but surely we have got to get to a position where interest rates are firmly impacting on the economy again. Nobody is quite sure whether, at 0.5%, they are or not.

The point I want to make, and the reason for asking you who should be urging the banks to hang on in there and not just immediately respond, is that just because base rate has gone up, does not mean you have to put up all your variable rates; you are already making a historically large margin. Just to finish off on that, I was in the markets myself, and of course on the way in very happy gilts traders saw a big buyer out there—as you do more and more QE, there is a massive buyer—so prices get pushed significantly upwards, and yields go significantly down; that is how the markets impact on it. There has been all this talk about whether it is brilliant economic management, but actually it is the reality of the markets. If they see that there is a big buyer, they will push the price up because they make more money, and therefore the yield comes down. That is how markets work.

On the way out, Governor King told us in this Committee that he would put up base rate by 0.25% or 0.5% and then unwind QE. That would be his way of calming the economy. Is it not the case that what will happen as a result of the markets is that the gilts traders will say, "Right, now there is a seller out there," so the price will shoot down and the yield will shoot up, like all sorts of analogies about things that shoot around the place? I was going to say something very out of order, but I won't do that. That is what will happen, because of the market impact. Therefore, the yield curve will go up instantly—is this not correct?—and if at the same time base rates look as though they are moving up, it becomes another field day for the banks and it is an absolute disaster for the real economy. That is my point: in that scenario, the day we put up base rate a tiny bit, everybody says, "Right, now we are going to unwind QE," and we have a disastrous picture on our hands.

Kate Barker: I made the point earlier about the fact that the Bank would probably announce a process of unwinding, which it will discuss with the DMO, and I suspect it would actually be quite modest, because it would be very anxious—

Q255 Andrea Leadsom: But it has already announced it.

Kate Barker: It has not announced anything about the pace.

Q256 Andrea Leadsom: Not the timing, no, but it has already talked about the process.

Kate Barker: Yes, but it has not talked about the pace or how much it would wish to do. We do not either, if I may say so, know the circumstance in which we will get to this. I completely agree with you that this risk is out there, and I am completely sure that the MPC will be very sensitive to it. That, I think, is part of the reason why we did not see rates raised in the periods that Andrew, and to some extent I, thought might have been desirable a year or so ago, because of this real worry about disturbing the curve and the fact that the first move will have a bigger shock. I find it terribly difficult to know what one can do about it, other than to say that it will really matter what the Bank says about its intentions at that time. That is, frankly, the only thing you can do.

I want to make a point I should have made in answer to your earlier point about the bank rate and other rates. The thing we did not talk about there was bank funding costs. Of course, they are lower now because of the FLS, but prior to the FLS, they were certainly not at 0.5%, which is one of the reasons why we have had these difficulties and uncertainties in the markets. What banks' funding costs are at the time we get these movements in the bank rate will also be important in the rates that they apply to both savers and borrowers.

Q257 Andrea Leadsom: I completely agree with that, but FLS in itself is creating more profit for the banks at present, isn't it, because the margins are still historically high? I completely accept that, prior to FLS, their own funding costs were high, but we now have a very interventionist marketplace where the banks are really making a lot of money out of this because their margins are still high. There is not the market pressure as yet. You have seen them slightly reduce, but the SMEs that I am talking to are just seeing that funding is now available, as opposed to unavailable; it is still very expensive. The banks are basically pocketing the difference and using it to mend their balance sheets and to do all the things that they need to do. It is not changing the fact that the second that we indicate that we have turned the corner, we end up with the markets creating a real problem.

Kate Barker: I think that is absolutely true as far as QE is concerned. To go back to the point about margins today, mortgage rates have of course moved down more significantly than SME lending rates, and that is not surprising, because people see mortgage lending as a better bet. Lending to SMEs in this rather uncertain economic environment that is lacking in confidence is still seen as more risky. It is, after all, SME lending where the banks have taken the bulk of their losses.

Dr Sentance: I want to pick up on Kate's point about communication. I know that you can say that the markets will not necessarily follow exactly what the MPC is saying, but this is a circumstance in which very good and clear communication is going to be important. Associated with that, it is very important that the Bank maintains its credibility, so that the markets are confident that it will follow through with action when it makes statements. When we get around to this exit, the communications and credibility of the Bank are going to be important.

Q258 Andrea Leadsom: I am just trying to press you. I personally feel that QE is part fiscal policy and part monetary policy. Is it not the case that, in the unwind, it really does stray into fiscal territory? In a sense, it boils down to markets, who pays, and the balance between how the monetary system hurts private families and so on. I understand what you are saying about the need for good communication, but is that enough? Does there not need to be a very clear strategy to avoid the kind of meltdown where the yield curve shoots up and margins go out and people get foreclosed on?

Dr Sentance: The organisation that the Bank would need to work closely with is the Debt Management Office. The Bank would need to ensure that its programme of sales of Government bonds fits in with the DMO. The Governor has always acknowledged that. Indeed, there was co-operation when the Bank was purchasing bonds. That is the key link that needs to be maintained to ensure that the markets behave in an orderly fashion. The links to fiscal policy more broadly are a slightly different issue.

Q259 Andrea Leadsom: On a slightly different tack, with your interest in the home loan markets and in housing and policy, Ms Barker, what do you think is the difference on the economy between the fact that, as I understand it, in the States there are many home loans based on long-term interest rates, which have therefore had a direct impact from QE, versus the situation in the UK, where loans tend to be more based—50:50—on short-term interest rates, which has therefore had less of an impact from QE? Would you say that that means that in the UK there has been more of a penalty for savers, versus help for borrowers, or vice versa? In terms of the differential in impact on savers and lenders in the US and in the UK, would you say there is a big difference?

Kate Barker: You have just asked a question to which I must confess I have given no previous thought.

Chair: Come on, Kate. You must have given it some thought.

Kate Barker: It was also asked in quite a complex way. I am not sure that I think that particularly, because QE has mostly had an effect on long rates and because the general effect of QE is, in any case, about trying to bolster the economy. Of course, people who have long-term mortgages in the US have the ability to repay them and to move down the yield curve, but I am not really sure that makes a tremendous difference. The way in which the mechanism works has much more to do with the strength of the banks in both countries and not particularly with the structure of the mortgage market. I think that is my answer.

Q260 Andrea Leadsom: We had some interesting evidence from Ros Altmann, who said that in the UK, QE has suppressed consumption. The over-50s tend to be the ones who have paid off their mortgages and have cash to spend, but because of the threatened impact on their annuity rates, they are saving rather than spending, whereas at the short end, because people tend to have mortgage rates that float or at least are fixed to base rate as opposed to long-term gilt rates, young people have not benefited from QE per se; they have just benefited from a lower base rate. Older people have been harmed by the low rates at the long end. To ask my question in another way, is that more intense in the UK than it has been in the US?

Kate Barker: I am afraid that I don't know whether it has been more intense in the UK than in the US. However, I will say that here even older people will have benefited from QE, to the extent that it has helped the economy grow, maintained confidence in the economy and the financial system, and enabled banks to go on lending to people at all. Of course, a number of people have, now, in the present circumstances, started to take out their mortgages at fixed rates.

To say that because QE stopped operating on the short-term rate, it has not had any further effect on younger people's ability to borrow is not quite right, because it certainly had an effect on the availability and supply of mortgages. I know that you will say, "Well, mortgage credit has remained very tight", but without QE, it could very well have remained even tighter.

I also agree that it has had a very negative impact on savers, and they have had to cut their consumption. I commented earlier that I remain somewhat uncertain about the exact effect of pushing rates quite so low. When we moved rates in the past, it always had a differential effect on savers than on borrowers. The belief was that it had more of an effect on borrowers, because you saw them as credit constrained. Because the effect on savers has been so extreme, it may very well be that they have reacted more than they normally would and, therefore, the balance between savers and borrowers has not been quite the same. That is the point about low interest rates.

I am not at all sure that I would recognise the effects from QE that Ros Altmann set out as being right, when I take the economy in the round. I do not deny that it has had an effect on the ability of savers to consume. On whether its effects on the economy as a whole have been bad or good, I still think that the benefits have been greater than the costs.

Q261 Andrea Leadsom: But that is the counterfactual argument again, isn't it? That is simply saying, "If we hadn't done it, things would have been a lot worse."

Kate Barker: Yes, but to dismiss that argument just by saying that it is a counterfactual argument is not—

Q262 Andrea Leadsom: I am not dismissing it. What I am trying to get at is the fact that it is straying into people's real lives.

Kate Barker: But monetary policy, bluntly and frankly, always strays into people's real lives. When I was younger and had a big mortgage, my life was strayed into substantially by the rise in interest rates. Then we had to calm inflation down—but it took many to the point of bankruptcy. That's how it is.

Q263 Chair: Your fundamental point, although you are being polite about it, is that you do not agree with Ros Altmann.

Kate Barker: I don't think I was being all that polite, but you are quite right: I don't agree with Ros Altmann.

Chair: You said that you were not sure, but you are actually very sure.

Kate Barker: I am quite sure that there have been bad effects on savers. I am pretty sure that the effects for the economy as a whole have been positive.

Q264 Chair: Poor Dr Sentance has not been allowed to say anything for some time. I know that the next question will be for Kate Barker, so I am going to bring you in.

Dr Sentance: I take a slightly different view. Ros Altmann was talking about the potential effects of QE. She has done some research that suggests that there have been some effects of this sort.

This situation comes not from having a short burst of QE and then moving back to normal, but from the fact that we are in a period of ultra-loose monetary policy, which has gone on for a long time. Once that period goes on for a long time, you begin to see some adjustments in parts of the economy where you perhaps would not normally expect to see a response to monetary policy. We have to keep an open mind about how positive for the economy a continuing period of low interest rates with further injections of QE could be. I am not sure, as we said earlier, that this is really going to provide much more stimulus to the economy.

Chair: We have had a good canter round this for almost 20 minutes. One more very quick question, and a very quick reply.

Q265 Andrea Leadsom: The final question is on the issue of accountability. As you both said in earlier answers, we have now effectively given the central bank a huge amount of responsibility with no accountability, as you have just said Ms Barker, because in effect you are laughing at the fact that monetary policy obviously affects people.

Kate Barker: No, no. The idea that I was laughing at it is not right. I described what in my life was an extremely painful experience. It is not remotely funny. I was describing what happens when you let inflation get out of control. Indeed, if I wanted to beat my breast about it, since I think we ran monetary policy rather badly running up to the crisis, I feel terrible about the way in which this has all worked out if you really want to know. I don't find anything about this funny or amusing at all, but I am making the point that it is not new that monetary policy has very differential effects on different people.

Q266 Chair: And you think that monetary policy should have been tighter in the run-up to the crisis?

Kate Barker: Yes, I do.

Q267 Chair: Substantially tighter, presumably, if you think that you didn't run it well, because the odd 0.5% wouldn't have made much difference to the confidence effects that you were trying to knock.

Kate Barker: It might very well have had to be substantially tighter. But I doubt whether we could have done it in the UK alone, since it was a global issue.

Chair: I am going to bring Andrea back for a very quick question, if you can frame it quickly.

Q268 Andrea Leadsom: Where is the accountability?

Dr Sentance: I think we have accountability mechanisms for the various functions that the Bank fulfils, and they are very important. One of them for the MPC is the letter exchanges, for example. I would have liked to see a bit more push-back from the Chancellor when the MPC was writing letters to say, "Inflation is going to be above the target. It'll come back." And perhaps the Chancellor could show a bit more concern that that was going to materialise. There are accountability mechanisms in the Financial Policy Committee as well, but the larger and the more complex the Bank's responsibility gets, the more challenging it is to operate in that environment.

Chair: I was going to ask you about accountability with respect to the internal arrangements within the Bank now that we have such a complex set of relationships between the PRA, the FPC and the MPC, with a shared chairman of all and membership of some. Rather than prolong it now, I might come back to you with a few thoughts on that after the meeting to see whether you have anything you would like to tell the Committee. Mark Garnier, thank you for your patience.

Q269Mark Garnier: Kate Barker, can we move away from QE? We won't be too long.

Kate Barker: I hope so. I'm terribly sorry, I didn't realise this session was going on for so long. If I am looking anxious it is because I am supposed to be somewhere else.

Chair: It is the price of giving good evidence.

Kate Barker: I will have to be terribly dull.

Q270 Mark Garnier: Your expertise on the housing market is extremely helpful. Can we quickly have a look at the help to buy scheme? I am very interested that one of the comments you made just now was that you thought that monetary policy was far too loose prior to the crisis.

Kate Barker: Too loose, yes.

Q271 Mark Garnier: Presumably that was all part of an inflationary bubble and the housing problems we have. You are obviously well aware that the Government have brought in this help to buy scheme. The Government are asserting that the scarcity of high loan to value mortgages represents a market failure. Do you agree with that?

Kate Barker: Up to a point. If you were to ask me whether I think there should be lots more borrowing at 95%, I don't think I do. There wasn't actually all that much borrowing, despite some of the headlines, at 95% prior to the crisis. However, I think the fact that there has been a shortage of, and quite expensive, borrowing above an 80% loan to value ratio does not seem to me a sustainable situation in the long run. I would expect in a more normally functioning banking system that it would be more possible to borrow less expensively at loan to value ratios of 85% and 90%.

Q272 Mark Garnier: Do you think the housing market is at a fair value now?

Kate Barker: I think it is at a reasonable value. If you think about rates at a higher level than they are today, and therefore mortgage rates at a higher level, and you looked at the income of people at the entry level in most parts of the country—not in London, which is a world of its own—and having this general concept in mind of 25% to 30% of income going out in mortgage payments, you would find that the housing market prices today are reasonably affordable. It strikes me that house prices are at a reasonable level.

Q273 Mark Garnier: But if interest rates go up it is going to change that, isn't it?

Kate Barker: No. This analysis was based on a normal level of interest rates. It was not based on today's rates.

Q274 Mark Garnier: Okay. The Government's proposals have come under quite a lot of criticism from a number of people. Do you think it is a good idea?

Kate Barker: The help to buy scheme falls into two parts. The first is a new-buy scheme. If you want me to comment on that I will have to reveal another interest. The second part is the mortgage guarantee scheme. We don't have all the details of the mortgage guarantee scheme.

Q275 Chair: That is the one we are interested in—the £12 billion scheme with no facts.

Kate Barker: I am more dubious about that scheme, particularly in the short run. Partly because it takes the supplier time to respond and also because it is not focused on new build in the way that the first part is, I am concerned that it will tend to push prices up in the short run. Earlier Brooks Newmark referred to the desirability of having some wealth effects in the economy. But I think there would be concerns if it pushed prices up too far. Whether that will happen is really unclear at the moment because we are so unclear about the scheme details. It is very hard to make a judgment on a scheme when details of the pricing are not yet known.

Q276 Mark Garnier: The housing market is not in an easy state to analyse, is it? We don't have that many transactions going on. We don't have that many mortgages going through. How can we be sure whether what is going on in the housing market is genuinely just that it is stuck or whether it reflects the fact that sellers of houses are not being realistic about the price at which people are prepared to buy? Allied to that is a natural tendency for the banks to manage their risk. Clearly they have had a big shock—part of the crisis was that they had a lot of defaults and the sub-prime housing market is part of that problem. But if you are a banker and trying to build a sound balance sheet, the one thing you will not want to do is necessarily to go out and lend high loan to value mortgages, even at 80%, if you are not convinced that the housing market is stable at its current level.

Kate Barker: That is absolutely right. It is one of the reasons why people are reluctant to lend. The other thing is that if you are not intending to do very much lending anyway, if the lending market is not growing very quickly, you would more naturally want to do the safer parts. You would in those circumstances tend to want to do the safer parts of lending. I thought the first part of your question was hinting towards the fact that one thing that would be a desirable feature, if it turns out to be true of the second part of the scheme, is that pushing up prices a little bit will enable us to see transactions moving again, and will enable us to see some liquidity in the housing market. That would be desirable for all sorts of reasons, labour market mobility being among them. It is not healthy to have a housing market in which people are quite so stuck.

Q277 Mark Garnier: Of course, this comes to an end in 2017 and then the FPC is being given the decision-making capability to continue, or otherwise. Do you think that is the right place for that decision to be made?

Kate Barker: Can I refer back? I am on record, since I wrote a pamphlet last summer, as commenting that I was personally uneasy about the FPC being independent of Government. I would have preferred the responsibilities which sit with the FPC to have been left with the Chancellor. So I am free to say that I would prefer this decision to be left with the Chancellor as well, in that context.

Mark Garnier: That is very interesting.

Chair: Has that silenced you, Mark?

Mark Garnier: It has a bit, Chair. I was looking to you to see whether you would carry on.

Q278 Chair: You have made that point before.

Kate Barker: I have, yes.

Chair: It is a very interesting point. You gave it in evidence to the Treasury Committee when we were looking at accountability structures. I am not going to revisit all those issues now. You have both been patient in allowing the session to run on, or not getting—

Kate Barker: Too impatient.

Chair: I thank you both very much indeed for all the evidence that you have provided today. We will come back to you with a few further questions for you to answer in writing if you can. Thank you very much indeed.