



Treasury Committee

Oral evidence: [Appointment of Gertjan Vlieghe to the Monetary Policy Committee hearing, HC 497](#)

Tuesday 13 October 2015

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Members present: Andrew Tyrie (Chair); Mr Steve Baker, Stephen Hammond, Mr Jacob Rees-Mogg,

Questions 1-50

Examination of Witnesses

Witness: **Gertjan Vlieghe**, External Member of the Monetary Policy Committee, gave evidence.

Q1 Chair: Good morning, Mr Vlieghe. Thank you very much for coming in to see us this morning. There has been a bit of speculation about your appointment in the press and it is to that that I want to turn. Before I do so, I just want to remind anybody watching this hearing that the predecessor Committee, and I expect this Committee too, strongly supported the appointment of people from the industry with wider experience than just being academic economists, not that there is anything necessarily wrong with them, or people from a relatively closed circle who have worked in central banking. It is extremely important in discussing codes of conduct, which we will turn to in a moment, that these are framed in a way that can create the flexibility to enable us to draw on the kind of expertise that you may have picked up. That is also something we will be looking at, in the course of this hearing.

I would just like to begin with a few very straightforward questions about the main source of public concern. You have had a stake at Brevan Howard, which you have now disposed of, and that has been a source of concern. Can you give the Committee an indication of its value?

Gertjan Vlieghe: I do not think I can. I would like to make a few things clear about the nature of that stake. There was a lot of misunderstanding in the way it was reported. People used words like “silent partner” and “continuing interest”, but it was nothing of the sort; it was exactly the equivalent to receiving a dividend from a public company but,

because Brevan Howard is not a public company, it is a private company, it was just an arrangement, a contract, a piece of paper that said, “You are entitled to X% of the profits of the asset management business.” That is all it was. It was also something that was not tradeable, in the sense that I could not demand to be bought out of the stake. It is entirely at the firm’s discretion whether to buy me out of it or not.

As to what it is worth, I do not want to give the exact number, both because it is commercially sensitive information and also my contract with Brevan Howard included a specific clause that prevented me from talking about any remuneration that I received, but I can tell you the net amount that I will receive is a couple of hundred thousand pounds. That is the order of magnitude.

Q2 Chair: The net amount meaning?

Gertjan Vlieghe: Meaning after fees and taxes, what I will actually receive in my bank account.

Q3 Chair: You are being paid how much by the Bank a year to do this job?

Gertjan Vlieghe: I am being paid around £140,000.

Q4 Chair: Although, by most people’s standards, this is a large sum of money, this is not life-changing. Variations in the value of your stake in Brevan Howard were not going to be life-changing for you. Is that what you are saying?

Gertjan Vlieghe: It is an amount of money that I would rather have than not have. Beyond that, I am not sure what else I can say about it.

Q5 Chair: When you went to Brevan Howard, did they need to make an exception to their rules to sell this?

Gertjan Vlieghe: They had to make an exception to quite a few rules, actually. I applied for the job; I did the interview; I then received the offer by telephone from the Chancellor’s office. I explained at the time that I was delighted to receive the offer, but I said, “My contract with Brevan Howard requires me to give a six-month notice period before I can leave, so I need a few days to negotiate that with them. There is no obligation on them to release me from that, so they may just hold me to it. I cannot accept the offer until I have had that conversation.”

I had the conversation and I said, “I would like to do this public sector job. Would you consider letting me go immediately, which is what I would need in order to do it?” They very kindly agreed to that. At that point, we did not discuss the buyout. I did not ask. I thought this was a big enough favour and deviation from their contractual obligation already to ask for and I was delighted that they let me do it.

Oral evidence: Appointment of Gertjan Vlieghe to the Monetary Policy Committee, HC

Q6 Chair: The issue of your stake was not discussed with Brevan Howard at that time.

Gertjan Vlieghe: Correct.

Q7 Chair: Brevan Howard has, as part of its business, trading the short end of the bond market, does it not, the short end of the yield curve?

Gertjan Vlieghe: Yes, that is right.

Q8 Chair: That is absolutely the bread and butter of what the MPC is most concerned about in trying to set interest rates, and so there is a potential for the appearance of a conflict of interest, is there not?

Gertjan Vlieghe: Actually, I can see that there might be an appearance but, if you really think through it, where would the conflict of interest potentially be?

Q9 Chair: You are asking me that question. Brevan Howard's profitability will vary according to the skill with which they predict variations in the short end of the yield curve.

Gertjan Vlieghe: That is absolutely correct, but—

Chair: I am sorry to interrupt, but you will be in a unique position on the MPC to give a view on which way that yield curve might move.

Gertjan Vlieghe: The issue as I see it is that, when I decide on interest rates, the conflict of interest would be if I also had an eye on the profitability of a financial firm, Brevan Howard or any other, that I have an equity stake in. In order for that to be a conflict, I would have to know whether that firm would benefit from interest rates going up, down or staying the same for longer than people expect. The fact is that I do not know. At any particular point, Brevan Howard may gain from an interest rate hike or may lose from an interest rate hike. I do not know. Even when I was there, I did not have an aggregate overview of the positions they took, because I worked in research, not in trading, and the positions change around very much. Now, certainly, when I am outside, I have no idea which way the positions go.

Q10 Chair: Rather than prolong this part of the discussion, we are both agreed that it is reasonable for someone to suppose that there was an appearance of a conflict of interest. You yourself have said that you can understand why people might have thought there was an appearance of a conflict of interest.

Gertjan Vlieghe: I can understand why some people asked the question. The fact that we have to have this conversation means that it is less than completely straightforward to explain why there is not a conflict of interest.

Q11 Chair: I think that is a very important point to have on the record. When you came to the Bank and you said you would like to come, you presumably disclosed this interest to them in their standard procedures for the disclosure of financial interests. Am I right?

Gertjan Vlieghe: I actually disclosed it much earlier. I disclosed it on my application form already.

Q12 Chair: What did the Bank do when they saw this?

Gertjan Vlieghe: The nature of my communications was I sent the application form; I was then called for an interview. We had the standard panel interview, at which it was not discussed. It was only when I received the offer that I said, “What about the stake?”

Q13 Chair: You raised it with them at that time, prior to taking up the appointment, but after having received the offer.

Gertjan Vlieghe: Yes, correct. In the conversation where I received the offer I said, “What about the stake?”

Q14 Chair: What did they say?

Gertjan Vlieghe: They said, “It’s fine; you can keep it. It’s in accordance with the rules that govern these things.” That was a conversation with the Treasury. Then I had a separate conversation with the Bank. I said, “What about the stake?” They said, “It’s fine; you can keep it. We have a code that says that people who have a stake in a financial company, when they arrive, if they have the stake already, do not need to divest it. This is exactly the bit that governs you and, therefore, you are okay to keep it.”

Q15 Chair: It looks, on the basis of what you have said, as if the Bank has misjudged the appearance of the conflict of interest that might exist. Is that not correct?

Gertjan Vlieghe: I do not think that is for me to say.

Q16 Chair: If you do not want to pass judgment on your new employer, I will not press you, but that is how it might also look.

Gertjan Vlieghe: Can I say something?

Chair: Yes, do.

Gertjan Vlieghe: As you yourself have said, it is important to have certain flexibility in the rules, so that it is possible to attract people from the private sector. Different people are going to come with different financial assets and financial liabilities, and the important part is to declare them, so that people then can take a view as to whether that is appropriate, and so I have declared it. The rules say that they must be declared. It is always going to be an element of judgment and, if there is an element of judgment, some people are going to say, “Well, I think it’s fine”, and other people are going to say, “I’m not sure it’s fine.” There is always going to be this area over which reasonable people will disagree.

Q17 Chair: We do not have all the facts but, on the basis of what we do have, it looks as if the Bank misjudged it. They have made that judgment and they misjudged it. They could have protected you from all this hassle by telling you that you had better get rid of that stake, just in case there is an appearance of a conflict of interest, even if there really is not one. Then we would not be having this exchange and this would be a much more straightforward hearing.

You have seen the letter of the Governor in response to a request of this Committee that the Bank reviews the way it looks at these conflicts, in which he said that the rules are fine in their present form. You have also seen what the Chairman of Court, effectively the chairman of the board of the Bank, had to say about it. He said, “I think I had better review it”, and indeed review it more thoroughly even than I was asking him to in that oral exchange. In the light of all this, do you think that a review is a good idea?

Gertjan Vlieghe: It is always good to review, but it is really not for me to say whether the rules need to be changed or not. It is for me to respect the rules as they are.

Chair: You have been through the odd hoop that you are probably unaccustomed to and that might have given you some experience from which to judge whether the rules need reviewing, but, if you do not want to pass a view, that is fine.

Q18 Mr Steve Baker: Perhaps we will come to the slightly more comfortable territory of economics. Could you explain to us how far you think weakness in the global economy will affect the UK?

Gertjan Vlieghe: There are some important aspects of the global economy and of what has happened in recent months that are worth talking through in a few steps. One is that a feature of the global economy over the last few years has been one that I would call systematic disappointment. Every year, people generally, forecasters and everyone, expects the next year to be slightly better than the current year, and every year that ends up not happening. There are very deep reasons for why that is the case, and the reasons have to do with a combination of debt and demographics, which means that there are headwinds

to global growth. We should not expect, even over the next few years, a meaningful improvement back to pre-crisis rates.

Initially, that debt burden took the form of a debt burden on the advanced economies that were at the epicentre of the crisis, but then, as soon as the worst part of the crisis was over, what you saw was very large capital flows to emerging markets. As advanced economies started the process of repairing balance sheets and deleveraging, you saw emerging leveraging up, which initially was good news, because it is an offset to the weak news in advanced economies, but it is not a sustainable source of growth. We have got to the point now where it has become clear that we have run out of ground there and, once again, the expectations for the global economy are being marked down and we have this persistent weakness.

How it affects the UK is clearly the UK is an open economy. It has very important trade and financial links to the rest of the world. The UK is in reasonably good shape. Growth is solid but not fantastic, but we absolutely have to take into account that we are working in a global environment and operating in a global environment that is adverse. It is a headwind to growth and one of the things that will prevent the UK economy from accelerating meaningfully from the pace that we are seeing currently.

Q19 Mr Steve Baker: Given what you have just said about debt, what would be a sustainable source of growth?

Gertjan Vlieghe: A sustainable source of growth is income. To be clear, what we are seeing is sustainable growth. We are just seeing sustainable growth that is lower than what we are used to, because people are in the process of repairing balance sheets and that is, in general, a headwind to growth. It causes growth to be lower than what it otherwise is. If what you are asking is how we get to a higher level of sustainable growth, we need a very prolonged period of reducing the debt burden. How you reduce the debt burden is by having very low credit growth or even no credit growth, and incomes catch up. The debt-to-income ratio reduces.

Q20 Mr Steve Baker: I am sorry; I am slightly confused. In your first answer, you did use the word “unsustainable”. What were you suggesting was unsustainable?

Gertjan Vlieghe: What was unsustainable was the debt build-up in emerging markets that followed the immediate crisis period. That was not a sustainable source for their growth. What we have seen over the last few years is a slowdown in emerging markets to a lower and more sustainable pace. What we do not know yet is whether that process has already stabilised and we will see growth, at this rate, stable going forward or whether it actually needs to go lower first.

Q21 Mr Steve Baker: To what extent do you see Chinese economic prospects as determining our own prospects and what is the role of British monetary policy in affecting the outcomes?

Gertjan Vlieghe: The prospects for the Chinese economy are one of the factors that affect the UK. I would characterise UK growth as I said a moment ago, which is solid, but not fantastic. The headwinds, the adverse forces, are that we have a reasonably strong exchange rate, which is up around 15% from its low a year and a half ago. We are operating in a generally weak global environment, so the exchange rate is a headwind, but if there was a strong exchange rate in a very strong global economy that would not be as bad as a strong exchange rate in a quite weak global economy. That is just one of the factors. Domestically, we have an ongoing fiscal headwind. That is also a headwind to growth.

On the positive side, we do have some improvement in productivity growth. We have some improvement in real wages and we also have a housing market recovery, and so what we are trying to judge is how those play off against each other.

Q22 Mr Steve Baker: The point I am getting at is whether you think that the British economy's prospects are now substantially linked to decisions by an authority in China, or is that not something that we should worry about?

Gertjan Vlieghe: The global environment of which China is an increasingly large part has always been important for the UK. I do not see that that is any different now. Maybe what is different now compared to five years ago is that China has been growing very rapidly, and so China's weight in the global economy becomes bigger over time. Their financial fortunes are one of the elements that affect the UK.

Q23 Mr Steve Baker: Your colleague Andy Haldane, in a speech in September, said his view was that "The balance of risks to UK growth, and to UK inflation at the two-year horizon, is skewed squarely and significantly to the downside." To what extent do you agree with him?

Gertjan Vlieghe: My view on the global economy is that, over the next few years, I can think of a number of reasons for it to stay stable, at these subdued rates. I can think of a number of reasons for it to deteriorate. I find it harder to tell a persuasive story about why it would improve materially so, in that sense, I agree that the risks are skewed to the downside.

Q24 Mr Steve Baker: Do you see the inflation target as symmetrical?

Gertjan Vlieghe: Absolutely, yes.

Q25 Mr Steve Baker: Given that it is symmetrical and interest rates are on the floor, what do you think we should be doing next? How worried should we be that we are in an environment near deflation?

Gertjan Vlieghe: I agree with the statement that has been expressed by a number of MPC members that the next move in interest rates is more likely to be up than down. It is also important to emphasise that, as I put in my questionnaire to you, right now, the indicators of inflation that I pay attention to—that is to say headline inflation, core inflation, wages, unit wage cost and the inflation expectation surveys—are all a little below where you would want them to be, to be confident of meeting the 2% inflation target in the medium term.

Now, there are good reasons to think that they will all rise over the next year, but we need them to rise. I am not confident enough right now that they will rise in order to vote for an immediate rate hike. We have time. We can wait and see how this plays out. I would want to see a more convincing broad-based upward trajectory, before I say I am confident enough that we will get to 2% eventually and therefore vote for a rate rise.

Q26 Mr Steve Baker: If inflation was at 4%, do you think you would be so moderate in your remarks about what should be done?

Gertjan Vlieghe: It entirely depends on why it is at 4%. Headline inflation is one variable in the mix. Ultimately, headline inflation is our target but, when we are trying to assess medium-term inflation pressures, headline inflation can be high for entirely idiosyncratic reasons that tell us nothing about medium-term inflation pressures, or it can be very informative. I cannot answer in isolation what if inflation was 4%; it would depend on everything else that is happening at the same time.

Q27 Mr Steve Baker: Is it not possible that we have just run out of monetary policy tools, that the intellectual scope for manoeuvre is now very limited and all of you in the monetary policy establishment are scrabbling around trying to find some way of justifying current policy and your expectations of where things will go?

Gertjan Vlieghe: I judge current policy to be where it needs to be; otherwise I would have voted for it to change, and in October I voted for it to be unchanged. I do think we have the tools. We can cut rates if we judge it necessary, if we were to be hit by further disappointment. We can also restart the asset purchase programme. Now, I agree with the findings of many researchers that the effectiveness of the asset purchase programme has probably declined over time; each successive wave was a little less powerful than the previous one, but that is not to say that we have no more tools and that it will do nothing. It just means we have to scale it appropriately.

Q28 Mr Steve Baker: We have just heard from the Governor at our last meeting quite a considerable rubbishing of the policy of people's QE to restart the

economy, and yet what I am hearing you say is that, if there is a further problem, you will restart the asset purchase programme. Do you see any parallels between people's QE and the arguments that were advanced by the Governor against it, and restarting the asset programme, which has the downside of boosting the value of assets held largely by wealthier people?

Gertjan Vlieghe: There are a lot of elements to your question. As I understand it, the definition of people's QE is evolving. What is important for the Bank to consider, what they have considered in the past and what we will consider in the future is what assets are appropriate to buy. When thinking about what assets are appropriate to buy, you think about assets that, when you influence their price, will deliver the right level of stimulus in the economy, but there are also other considerations. You do not want to advantage one sector of the economy over the other, because then you are making distributional decisions, which are not for the Monetary Policy Committee to make. As long as any purchase programme respects those elements, then it is right for the Bank of England to consider it. However, the Bank of England also has operational independence to buy the asset it sees fit to achieve the inflation target. Right now, we are in an environment where that is for the Bank to consider.

Q29 Mr Steve Baker: I detect that the Chairman might want to move on but, from what you have just said, you clearly accept that monetary policy can have redistributive effects.

Gertjan Vlieghe: Yes, absolutely. It always does. Even when it is just interest rates, interest rate changes are good for borrowers or good for savers, depending on whether they go up or down. That is always the case.

Q30 Stephen Hammond: Good morning. In your written evidence to the Committee, in terms of looking at the unwinding of QE, you said that one of the challenges was "a transition challenge". "A prudent approach ... would be to sell the assets over a longer period of time, and to begin asset sales only after interest rates have been raised well above their effective lower bound." Just so the Committee is clear, because you will obviously know that a lot of this is nuancing and whatever, what do you regard as a long period of time for those asset sales? Can you talk a little bit about effective bands and where you see the effective lower band being?

Gertjan Vlieghe: The reason I did not put numbers on any of them is that I think we have to leave adequate scope for adapting to the circumstances as they arise. Let me give you two examples of how the level at which we think interest rates need to be before beginning asset sales might be different in different circumstances. One is we are in an environment where growth is very strong, inflationary pressures are clearly picking up, we are increasing interest rates quite frequently and we can see further down the road that circumstances are likely to be such that they continue to increase quite quickly. Obviously, at any point, we might say, "Okay, we're comfortable now. Even though we haven't increased interest rates very much, we are comfortable now to start asset sales",

because we can see that we are very likely to continue increasing them thereafter so, within a few more quarters, we will be at an even higher rate.

Contrast that with another situation where interest rates go up much more tentatively, and each one is a very fine judgment about whether indeed one more hike is necessary. If we are in that sort of circumstance, we might well want to hike to a higher point before we consider asset sales, because we are not confident that the upward trajectory will continue.

Q31 Stephen Hammond: Is that not where we are at the moment, given what the Bank has said and Monetary Policy has said, that, in the balance between inflationary and deflationary risks, even though there are some inflationary pressures in the economy, the deflationary risk is still higher? We are much more likely to be in your second scenario, rather than your first scenario. That is where we are in policy terms, at the moment.

Gertjan Vlieghe: At the current juncture, that is also where I think we will find ourselves, with these more tentative interest rate increases, but it will entirely depend on the circumstance. Therefore, the threshold at which we would think it is appropriate to start beginning asset sales will also depend on the circumstance.

Q32 Stephen Hammond: Related to all of this, of course, is productivity and the output gap. The Governor stated in the August inflation report, which you will obviously have read, that in his judgment 0.5% of GDP was about the gap at the moment. Then he used the interesting phrase, “There’s a wide range of views on the Committee about exactly where that is.” Do you think there is actually any particular advantage in trying to understand this concept? Is it significant for economic analysis? What is your view of what the gap actually is?

Gertjan Vlieghe: The output gap is just a way to usefully summarise your view on a number of things, which then comes down to whether we can sustain a little bit more of above-potential growth, before inflationary pressures start to build up, or whether we are already there. That is what the output gap says. There is no very clear direct analysis that gives you the answer. You consider everything and then, in a way, you reverse engineer: “If I think all that about the economy, if I am logically consistent internally, then I must think this about the output gap.” It is more a communication and analytical device, rather than something that we go out and measure and say, “Oh, there it is.” It is completely unobserved. That is about the output gap.

About the wide range of views and 0.5%, the point that I think is important is highlighting that monetary policy before the crisis—I am oversimplifying to make the point—was roughly a situation where we thought of the neutral rate as being somewhere around 4% or 5%. Then, as the economy deviated from potential, we thought that however far it deviated from potential was roughly how far you want to be from the 4% or 5% interest rates, either above or below. Monetary policy was largely driven by these output gap views.

Now we are in a situation where there may not be that much slack anymore. Somewhere between 0% and 1% is a reasonable characterisation of the plausible range, but actually the big question is not just about that. The big question is, even once there is no more slack, what is the appropriate level of interest rates. There are good arguments to think that the appropriate level of interest rates when there is no more slack, which some people call a neutral or natural interest rate, is several percentage points lower than what it was before the crisis. Just because you think there is no more slack, it does not therefore immediately follow that you think interest rates are incredibly wrong at the level they are now.

Q33 Stephen Hammond: Given your answer to my previous question about the unwinding of QE, your view at the moment must be that there is that sort of slack in the economy. Given the more tentative approach to interest rates, which we agreed from your answer, your view is that there is still some considerable slack in the economy.

Gertjan Vlieghe: Actually, what I was trying to argue was that it would be entirely consistent with my story to say that, even if there was no more slack—

Stephen Hammond: I understand that point. In the question about the unwinding of QE, we agreed that you think there is going to be a more limited step-up in interest rates. Do you not therefore think that there is still a reasonable amount of slack in the economy?

Gertjan Vlieghe: I do think there is some slack left in the economy. The point about the discussion about the neutral rate is that it is likely the neutral rate is very, very low right now and only rising very gradually over time. The appropriate interest rate, even when there is no more slack, is likely to—

Q34 Stephen Hammond: One of your colleagues on the Committee, David Miles, has postulated a new normal rate of about 2.75%. Is that the sort of area where you would expect it to be?

Gertjan Vlieghe: It is incredibly difficult to judge, because these are all relatively new questions for monetary policy-makers and economists. I have spent quite some time analysing this and thinking about it and, currently, all the economic data and all our experience of recent years tells me that it is more likely to be between 1% and 3% than between 3% and 5%. Within the 1% and 3%, I know that it is still a wide range, but it at least makes the point clearly that it is several percentage points lower than where it was before.

Q35 Stephen Hammond: Linked into all of this, of course, is the productivity issue and the puzzle. Again referring to your written evidence to the Committee, you talk about “normal flows of workers and capital between firms”. One of the reasons for productivity not picking up, I think you are suggesting, is that the “the normal process of resources flowing towards their most productive use was impaired”. Can you give us some indication of where we are in repairing that normal

process and how you see that normal process being reinstated, because that allocation of capital is key to growth going forward?

Gertjan Vlieghe: I can point you to some of the data that I look at to come to the conclusion that this is the case. In the case of reallocation of capital between firms, what we observe, which is rather indirect, and this is something that Ben Broadbent has done some analysis on, is that the return on capital across firms has a very wide dispersion, much wider than is historically the case. Normally, when some firms have fantastic opportunities and other firms do not have great opportunities, you would expect capital to flow to the firms that have the fantastic opportunities, until that rate of return goes down and roughly equalises across the firms. We see that happening much less. We do not observe it directly, but we observe it indirectly by seeing, there's this great dispersion in the rates of returns across firms.

On the worker flows, the evidence is rather more direct. There are always lots of gross flows of workers in and out across firms, and we just observe that those flows are still depressed relative to what they are in normal times. We know that firms are probably still hampered by that. Our aggregate productivity is probably still hampered by the fact that those flows have not returned to normal.

Q36 Stephen Hammond: The other part of your evidence to us was about disaster risk or extreme event risk, which you highlight as firms failing, even with very low interest rates, to undertake new investment. Clearly that happens but, coming out of the extreme event, therefore you take the view that there has been one extreme event and take a view on another one in the future. Coming out of what has been the worst financial crisis for 50 years or whatever, is it not also true that the rebuilding of bank ratios is having an impact on the allocation of capital, and therefore that not all of the way the banks are lending is into the most productive sectors of the economy?

Gertjan Vlieghe: That is also a factor. I am not sure I understand the link between that and the disaster risk point.

Stephen Hammond: The point is that, rather than the firms being too scared by the point of disaster risk, it is the banks perhaps being too scared by disaster risk.

Gertjan Vlieghe: I think it is broadly both. We have observed that banks have repaired their balance sheets through a number of different things—by retaining earnings, by issuing more equity, by disposing of assets. We observe that they are now already well above where, on average at least, the bank regulation requires them to be, so they are being extra-cautious, and firms are also being extra-cautious. Even though risk-free interest rates are very low, it appears, not just in the UK but globally, that firms still require a very high hurdle rate before they decide to make an investment, despite the fact that risk-free rates are much lower. Both play a part.

The bigger point I was trying to make, when people talk about the productivity puzzle and say there is 10% to 12% unaccounted for, is that lots of people then do studies and look at one potential answer, because their studies are very complicated and you can really only

examine one answer at a time. Then they say, “This only accounts for one or two percentage points of the puzzle, so this does not account for all of it.” Then somebody else does a study into a different answer and says, “That only accounts for 1% or 2%”, but actually, if you then have five different mechanisms and all five mechanisms account for about 2%, then you have explained your 10% gap. I think people are just a little bit frustrated, because they would like there to be one answer, one easy-to-digest story, and there is not. A number of things have each made a small contribution, which adds up to a large total.

Q37 Stephen Hammond: One of the things is that a number of analysis points are making a small contribution—I agree; you have identified five different risks—but, since 1990, there has been a huge change in the developed world in the supply of people prepared to take low-skilled low-wage jobs. That trend has been prevalent since 1990 and we are potentially about to see another flow of that. Do you have any views on the oversupply for low-wage jobs? Has that had a systemic shift downwards in overall ability for developed economies to reach the productivity levels they were pre-1990?

Gertjan Vlieghe: I am not sure. The way I think about flows of relatively cheap labour is that economics has called it a positive labour supply shock for a number of economies in the world, including for the UK. I am not sure I would want to then immediately leap and make the link to low productivity. Clearly, there is the narrow issue that there are changes in the composition of the labour force, as has been documented in recent research and in the inflation report, which have pushed productivity up or down at different stages. As to the secular trend, that we have lower productivity growth now because we have cheaper labour, I do not think that follows.

Q38 Mr Jacob Rees-Mogg: Moving on to another part of your evidence on the household debt-to-income ratio, which you are concerned remains elevated, what would you see as a better level for household debt? Where do you think it ought to be?

Gertjan Vlieghe: That is a million-dollar question lots of people have asked me when I worked in the private sector. Every time I talked about, “Debt is too high; it is a headwind to growth”, people would say, “Well, where does it need to be?” Unfortunately, I can do no better than to say somewhere between where it was before the run-up and where it was at the peak. What we can say right now about the debt-to-income ratio in the UK is that it has come down significantly from the peak, not because of an actual reduction in nominal debt, but simply because nominal debt has remained roughly frozen and incomes have caught up. In round numbers, we have only unwound roughly a third of that run-up.

The second part that is really important is that is just a point about the aggregate debt, but then we need to look at the distribution of the debt. We need to focus on where in the income distribution are the households that are more vulnerable. That is research in which the Bank invests a lot. There is, twice a year, an NMG survey, where we look at that and keep a very close eye on, if there were to be an interest rate increase, what the impact would be on these groups of financially more vulnerable households.

Q39 Mr Jacob Rees-Mogg: Do you think that much of the household debt is essentially bad debt that, because of very low interest rates, the banks have not had to write off? They have been able to accept interest-free payments and just keep things going but, in a more normal interest rate environment, they would have to write those debts off, which might indicate that the household debt situation is rather better, if only you could take out the effect of the bad debts.

Gertjan Vlieghe: I have not seen convincing evidence of the story that you are saying, that it is really bad debt that has not been realised or written off. Clearly, if we were to increase interest rates by some enormous amount, then yes, that would hurt a lot of households and turn a lot of that debt into bad debt. The reason why we are not increasing interest rates by some enormous amount is not just because it would hurt those households; it is because the wider economy does not need that increase, so I do not think that that quite follows.

Q40 Mr Jacob Rees-Mogg: To the extent that there is zombie debt, do you think it is in the corporate sector, rather than in the household sector, or do you think that it is not a problem, that there is not any debt left that the banks are just keeping going because they do not want to take any more bad debts?

Gertjan Vlieghe: No, I do not think that there is convincing evidence for that.

Q41 Mr Jacob Rees-Mogg: You were advising Mervyn King in 2004 to 2005, so a few years before the crisis. Do you remember what you were saying about household debt at the time? Has this been a constant theme of yours?

Gertjan Vlieghe: I was working on household debt as one of the strands of research at the Bank. We did discuss it at the time. This was of course still an earlier phase in the household leveraging, but it was already a concern. Indeed, in speeches at the time, the Governor mentioned worries about the household sector.

Q42 Mr Jacob Rees-Mogg: On the other side of the coin, the savings rate is low and interest rates are low, so it is not a hugely good environment if you are interested in saving. Is there anything that can be done about that? What would you like to see happen to savers in the UK?

Gertjan Vlieghe: If we could write the recovery that we wanted on a piece of paper, we would obviously have one that is broadly balanced across the economy and that has a reasonably high and sustainable savings rate. However, it is entirely the logical counterpart of an environment where interest rates are very low because that is what the economy demands that also we see a low savings rate. I do not see that that is something that we, as monetary policy-makers, need to do something about. The way we take it into account is that, going forward, we do not expect a source of growth to be a big further decline in the savings rate. We would only expect a source of growth in the household

sector to be a sustainable growth in income based on wage growth and productivity growth. In that sense, it affects our view.

Q43 Mr Jacob Rees-Mogg: Why do you think the Japanese, with very low interest rates, carry on saving very significantly, whereas in the UK with very low interest rates, almost any type of interest rate actually, savings have been declining? Have you done any work on that? What is the difference in our economic structure that makes people in Japan more likely to save?

Gertjan Vlieghe: I have not looked a great deal specifically at the determinant of the savings rate in Japan and in the UK. I do observe that the demographic situation is very different across the two countries, and demographics are a big determinant of savings. Households, through their age cycle, have very different saving rates—young from middle-aged from older households. Therefore, whether your economy consists of primarily young, primarily middle-aged or primarily older households has a huge effect on your average savings rate, and I suspect that is one of the things that explains the difference between Japan and the UK.

Q44 Mr Jacob Rees-Mogg: On the whole picture of this, and on to consumption now being more sensitive to interest rates because of low savings and high debt, do you think that interest rates may need to change at smaller levels, less than the quarter of a percentage point level that you have come to expect?

Gertjan Vlieghe: I know that question has come up a few times. Personally, I do not see the case for it. I think, if we thought that interest rates needed to move by fewer than 25 basis points, it is more likely that we would decide just not to change them.

Q45 Mr Jacob Rees-Mogg: You mentioned earlier that interest rates might need to be cut. If you cut them by 25 basis points, there is not a lot left. There is not a lot left anyway. If you were cutting, do you think it might be more likely to move by an eighth of a per cent, rather than a quarter of a per cent, or is it all the same answer?

Gertjan Vlieghe: It is possible. We have to be respectful of the coarseness of all these parameters and how much we think we can influence the economy in a particular direction. All these estimates are terribly uncertain. If you are in a situation where you think the economy needs either higher or lower interest rates, it is very unlikely that you will find yourself in a situation where you think 10 or 12 basis points, an eighth of a percentage point, is going to make that much difference.

Q46 Mr Jacob Rees-Mogg: In the event that you have become more concerned about deflation than inflation, there are very few tools left. Is that fair?

Gertjan Vlieghe: No. I said earlier that we can cut interest rates if we need to and we can also do more asset purchases. There is a long road there to travel.

Q47 Mr Jacob Rees-Mogg: You noted that the later rounds of quantitative easing became less successful. There is only 0.5% left of interest rates. Are you with Mr Haldane and the idea that we should have negative interest rates and abolish bank notes?

Gertjan Vlieghe: No. The way I think about that is it is an interesting musing to think about the world 20 or 30 years from now. If everyone has moved to electronic money, then that would have the implication that interest rates can go a lot more deeply negative than they currently can. I think of it in that category. It is not on the menu now for monetary policy options.

First, I want to repeat that I do think the next move is more likely to be up than down. I would have to see some material disappointment, relative to my outlook, before I think an interest rate cut or further stimulus would be appropriate. I would also like to make the point—maybe this is what you are getting at and, if that is what it is, then I do agree with you—that, quantitatively, we have much more scope to remove stimulus or to put the brakes on than to stimulate further. That is quite different from saying we have run out of road, but it does play a part in my deliberations. I think, if something really big were to happen on the upside, then we would have loads of room to tighten and sell assets. On the downside, we have some room, but its effectiveness is probably less than what it is in the other direction. I do see that asymmetry.

Q48 Mr Jacob Rees-Mogg: Therefore, the need to think of innovative solutions is more pressing on the downside, which makes what Mr Haldane said so interesting, even if it was something that would be very hard to make work. It is important that the Bank is thinking of what the next step is, in the event that we are in a situation like Japan, where you have 20 years of very low interest rates and fitful economic growth at best.

Gertjan Vlieghe: We are constantly evaluating what the tools are but, for now, for the kinds of shocks that we might be hit with, in the next couple of years say, the interest rate cuts that are possible and the quantity of asset purchases that are possible are still entirely fine. We are not in a situation where we have run out of road.

Q49 Chair: Thank you very much. I have one question I want to finish with, which you partly answered there. Basically you are saying that we have not run out of road for stimulus, and therefore you disagree with Larry Summers and others. I expect you saw Larry Summers' long piece in the *FT* recently, in which I think he said that monetary policy is all played out. You are disagreeing with that, are you not? Monetary policy is not all played out.

Gertjan Vlieghe: Yes, I think monetary policy it is not all played out.

Oral evidence: Appointment of Gertjan Vlieghe to the Monetary Policy Committee, HC

Q50 Chair: It just plays wrong, not for the first time either. Today you are sounding dovish on several fronts. I do not know whether you have assembled your thoughts with that intention, but that is how it is coming across. It is harder to tell a story about global growth picking up than global growth slowing down. You did not say the latter, but you said the former. Even if all the slack is used up, it does not mean that rates are wrong where they are now, I think you said. In your questionnaire too, you gave a pretty dovish set of replies. Is there anything you want to correct in my summary of the evidence we have heard this morning?

Gertjan Vlieghe: No. I think this is my cue to say something about the hawk/dove thing, so I will take it. I do not mind the fact that commentators use the hawk/dove spectrum. I used it myself when I worked in the private sector. One important point I would like to make is that it is a useful characterisation, for example for members on a committee, not just in the UK but in any country, at a particular point in time.

Where it becomes unhelpful, and the reason why you will never hear me apply the label to myself, is to think that it applies for all times. As we have seen, even at the Bank of England among Committee members who have stayed on the Committee for a long time, people might find themselves at the dovish end of the spectrum at one point and then the hawkish end of the spectrum at another point. A switch is possible. It is useful, at any particular point in time, for outside observers to say some people would be closer to a rate hike and some people would be further away from a rate hike, for example. It is on a spectrum. There is always a range of views and, if people want to use those labels outside, then I have no problem with that.

Chair: It has been helpful to have your frankness that, from the outside, you yourself have used these labels, but now you are on the inside you have decided that you are going to disapply them. Thank you very much for giving evidence to us this morning in a thoughtful and illuminating manner.