



Treasury Committee

Oral evidence: [Bank of England inflation report](#),
HC 61

Tuesday 24 May 2016

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Members present: Mr Andrew Tyrie (Chair); Mr Steve Baker; Mark Garnier; Helen Goodman; Stephen Hammond, George Kerevan; John Mann; Chris Philp, Mr Jacob Rees-Mogg; Wes Streeting. Rachel Reeves

Questions 1-138

Witnesses: **Dr Mark Carney**, Governor, Dr Ben Broadbent, Deputy Governor, **Dr Martin Weale**, and Dr Gertjan Vlieghe, Monetary Policy Committee, Bank of England, gave evidence.

Q1 Chair: Thank you very much for coming in today, Governor. The first question that, it seems to me, we need to address, given that you and the Bank have now intervened a second time in the Brexit debate, is to ensure on behalf of Parliament that you have not overstepped the mark and entered what might be called the political sphere. The second question is, informing your judgments, whether you have come to reasonable ones. Those are the two key issues that we need to address today. I would just like to begin with the first. What rule and guidelines, internally, are you using, on the basis of which you are taking forward your work on Brexit?

Dr Carney: All our work is governed by our remit: to promote monetary and financial stability. With respect to the topics today, we have the responsibility under our remit to report not just the current trade-off that may hold in terms of returning inflation to target in a sustainable manner but the principal risks around that trade-off. That is clearly set out in the remit letter from the Chancellor to myself in my role as Governor. It is consistent with the approach we have taken since the publication of the Stockton report, which recommended precisely this type of analysis. It is consistent with the Warsh report and our other responsibilities. That is the general guiding principle—

Q2 Chair: What I am really after is that each time you make these interventions you must be acutely conscious of the risk that you could stray into the political sphere or be accused of doing so. Indeed, you have been. So what I want to establish is what principles or guidelines have been laid down internally, on the

basis of which you are going about this work, bearing in mind the sensitivity of it? Perhaps I could put it in the context of a precedent: in the run-up to general elections, what rules, guidelines and standards do you seek to stick by?

Dr Carney: It has been the convention—not a requirement—that the Bank observe in a general election rules and guidelines consistent with the purdah guidelines for the Civil Service. That is a decision of the Bank. We have adopted, for the purposes of the referendum, substantially the same rules as the Civil Service, with one important exception. As you will be aware, the responsibility of civil servants is to continue to serve their Ministers, in support of government policy during the course of the referendum. Our responsibility is to Parliament and to the people of the United Kingdom. We are not responsible to a Minister. We are responsible to Parliament and the people of the United Kingdom, so we make an explicit exception to that. We are not supporting government policy.

To go back to the purdah period that begins shortly, there will not be public speeches by members of the Bank, with the exception of the Mansion House speech, which is 16 June. I can tell you what that speech is going to be about. It may empty Mansion House.

Q3 Chair: We do not need to go through all of this in great detail. The more helpful thing would be if you could publish those guidelines as soon as possible after this hearing, so we can take a look at them. You have told us that they are written down, they are internal guidelines, and I think we need to see them as soon as possible. Those are guidelines that were presumably drawn up for the purpose and with the intention of thinking through how the MPC might have conducted itself post-independence. What amendments or adjustments have you considered to them in the light of the fact you now have a financial stability statutory requirement?

Dr Carney: We are applying these guidelines to all of our policy committees and to the institution as a whole.

Q4 Chair: They may be very different; a financial stability risk may come in a very difficult way.

Dr Carney: I was going to come onto that. We have a responsibility to continue business as usual. So let me give you two examples of business as usual. The first is that we have a monetary policy decision on 16 June. We will make that monetary policy decision. With that monetary policy decision will be, as is the practice, the publication of the minutes and the monetary policy summary on the same day.

Q5 Chair: But you are not intending to publish any further commentary on Brexit, as you have here in this report.

Dr Carney: We are not publishing an inflation report. If the judgment of the Monetary Policy Committee is that there are issues that are relevant to the achievement of the inflation target, we will comment on those.

Q6 Chair: So Parliament and the public should not exclude the possibility that you will make a further intervention in the Brexit debate?

Dr Carney: Chair, one should not exclude it but I will give my personal view on this, which is that we have, with this inflation report and most recent decision, minutes and letters to the Chancellor, set out the broad economic issues and the drivers that could affect the trade-off. We have also observed that, given some of the uncertainty engendered during this campaign period—this is an important point—there is a higher bar in reading current economic data to give a sense of the underlying momentum in the economy, a point I hope we will come onto in this hearing.

Q7 Chair: Meaning what, exactly—“a higher bar”?

Dr Carney: There is a higher bar, because there is in our judgment—not just my judgment, but the judgment of all of the other members of the committee—a substantial degree of uncertainty at the moment. We can see it in our uncertainty indicator. One has to be careful and humble about the exact mapping of that uncertainty to the direct impact on underlying economic variables, at present. Reading hard and soft data, we could be overestimating or we could be underestimating the underlying—

Q8 Chair: We understand that, but that is a question about how you are going about your work. I am asking what it is that you are prepared to do, and you are not excluding the possibility of a further intervention on 16 June, in a manner that may influence the Brexit debate.

Dr Carney: Chair, what I was building up to was to say that we, in my judgment, have highlighted the key economic issues, including short-term uncertainty and this potential change in the trade-off between output and inflation. So I would not expect something substantially different to be said.

Chair: So you are not intending to, but you do not exclude the prospect.

Dr Carney: I am not intending to, but I am one person on the committee.

Q9 Chair: I understand. That is why you have expressed a personal view.

Dr Carney: Exactly.

Q10 Chair: But you, the Governor and the chairman of the committee, are not intending to, and that will be your personal view that you are going to express, unless you feel that there is some overriding need. Is that correct?

Dr Carney: That is my view, yes.

Q11 **Chair:** Do you think it is reasonable for the IMF to step in a week before a referendum?

Dr Carney: We are on the Article IV cycle for the IMF.

Q12 **Chair:** That has a high degree of flexibility. I have the dates for previous Article IV cycles in front of me, and there is no need for them to turn up a week before a referendum and jump in with both feet like this.

Dr Carney: Quite frankly, I have no influence on the timing of the IMF.

Q13 **Chair:** I am not asking you that. I am asking you what you think about it.

Dr Carney: I think the thrust of the IMF's views around these issues has already been expressed.

Q14 **Chair:** Alright, so do you think it is a sensible idea for them to come over and express it at another time?

Dr Carney: I think this will be a detail, candidly.

Q15 **Chair:** Bearing in mind that you yourself have just said you are not intending to put even your toe into the water unless you have to, and from what we hear the IMF are intending to turn up and jump in with both feet.

Dr Carney: First thing, I said I would not expect anything substantially different, in terms of the economics. So let me give you an example—a hypothetical, but we are speaking in the hypothetical—which is that on the degree of uncertainty engendered by the referendum campaign and its impact on economic variables, I would not exclude the possibility that there is some evolution of the committee's thinking on that. I am one member of the committee. We will have a few more weeks of data. Things will move around. There may be a judgment around that. There may be a judgment about underlying momentum in the economy as a consequence of that. So I do not want to be drawn on a technicality to say that that is something different from what we had said in May. My point being that that is exactly the same economic issue. I cannot see a different economic issue being introduced, and certainly not a substantive judgment about the underlying issues. It is only going to be grounded in—

Q16 **Chair:** You have strayed quite a long way from the question. The question is whether you think it is a good idea that an intervention, whether it is a minor or major one, should be made a week before this referendum by the IMF.

Dr Carney: I did not stray from the question, if I may. I corrected a potential impression that might have been created by your characterisation that I said we would not put our toe in the water, which was an introduction to the IMF. I needed to correct that, because I do not want that coming back.

Chair: You have made clear that there are circumstances in which you might put your toe in the water.

Dr Carney: Thank you.

Q17 Chair: I am not asking you that question. I will go back to the question I have been asking, and I will have a go a third time. You have had plenty of time to think about it now. You have had several minutes. Do you think it is a good idea for the IMF to come over a week before a political event of this importance and controversy and jump in with both feet?

Dr Carney: I think it is a detail, candidly. I think a staff report on these issues, just like a staff report on housing, etc, from the IMF, is a detail.

Q18 Chair: I am sure we will take a good deal of interest in the detail when this detail takes place. Can I turn to you, Dr Weale, and ask you about your speech the day after the inflation report was published, in which you said, “The impact of aggregate uncertainty on household consumption is likely to be rather small”, and, quoting again, referring to uncertainty, “The level is still appreciably lower than it was between late 2008 and 2012, and not very different from the experience of the Far Eastern crisis of 1998 and the build-up to the war in Iraq.” Let me ask you, rather than trying to lead you in a particular direction, what you meant by that?

Dr Weale: As the Governor said, we have been examining the influence of uncertainty on the economy. The Bank has produced, on page 14 of the inflation report, an analysis of the finding of that work. I was essentially describing those findings: that uncertainty as we measure it has increased, but the rise in uncertainty does not match what was happening during the financial crisis.

Q19 Chair: We are hearing quite a few dire warnings about the consequences of Brexit. The Bank has made some that might fall somewhat short of dire, but they are certainly warnings. The Treasury has also weighed in now with two documents, particularly a very recent one published yesterday, although heavily trailed beforehand. Have you had a chance to look at that, and do you agree with its findings?

Dr Weale: I certainly take the view that Brexit, to my mind, would be quite likely to have a material impact on both growth and inflation.

Q20 Chair: By which you mean negative impact?

Dr Weale: It would be likely to have a negative impact in the short term. Those points are no more important than whether I agree with the precise profile.

Q21 Chair: I am always interested in your views, Dr Weale, as a free-thinking guy.

Dr Weale: I certainly think that would increase the risk of recession. In the earlier part of my speech, I drew considerable attention to the uncertainty surrounding economic forecasts, so I certainly could not say that this or that will definitely happen. The future is uncertain, and at the Bank we have always tried to stress that. To my mind, it would pose a material risk to growth and inflation over the horizon that the Monetary Policy Committee considers—

Q22 Chair: Do you agree, Dr Vlieghe?

Dr Vlieghe: I do not want to give a running commentary on every report that analyses what may or may not happen to the economy. I think the MPC speaks in its own voice on this, and we have discussed this in the minutes and in the inflation report, and I agree with that analysis that we have put out. That is that it is likely there would be a material slowing in growth, and it is likely that inflation will rise, and that the exchange rate will fall.

Q23 Chair: So the answer is yes.

Dr Vlieghe: That is my answer.

Q24 Chair: Dr Broadbent?

Dr Broadbent: I will give exactly the same answer.

Q25 Chair: Is there anybody on the MPC whose view differs in any material respect from that conclusion, Governor?

Dr Carney: An experienced reader of our minutes would know the answer to that is no. There is no qualifier in front of those conclusions. The qualifier we use is “the best collected judgment of the MPC”; that is when there is a range of views around something, or some members think this and other members think that. The answer is no. Everyone on the MPC has that view. All nine independent members of the MPC, I might add.

Q26 Chair: You have discussed this extensively with the FPC as well, a consensus-forming institution. Are there any dissenters to that view on the FPC?

Dr Carney: I would distinguish what the MPC does for the inflation report. I know you know this, but it is important to have this on record—

Q27 Chair: I do not think we need to go around and rehearse that all over again. With respect to the financial stability remit, on which Brexit must clearly must have a bearing, do you have a committee that is united in the view that the downside risks are significant and outweigh the upside risks?

Dr Carney: It is the view. It is a consensus view of the FPC that Brexit represents the most significant downside domestic risk to financial stability.

Q28 **Chair:** There are no dissenters to that view.

Dr Carney: No.

Q29 **Mr Rees-Mogg:** Gentlemen, good morning. The MPC has a normal convention that it follows government policy, not other things that may become policy later. Why was this not followed?

Dr Carney: The convention is that, for the purposes of our forecasts, we follow government policy. For a major government policy, whether it is the stance of fiscal policy or in this case in the case of government policy, which is to remain a member of the European Union, those are used to condition our forecasts, so it was followed in this case.

Q30 **Mr Rees-Mogg:** In general elections, you do not give a view on opposition parties' economic policies. Why not?

Dr Carney: In general elections we observe the same convention, which is to follow government policy. Let me take a step back, if I may, and provide the overall context, which is based on the experience with inflation targeting, the adjustments to the remit, and the Stockton report, which looked at how we forecast and how we could provide a richer sense of what our forecast is and how we could adjust policy for various shocks or uncertainties. We have a responsibility—and we have done this consistently—not just to provide a base forecast but to identify the biggest risks to those forecasts and give a sense of the dynamics around those risks and how, if those risks manifest, it may affect monetary policy; it helps understand the reaction function of the MPC and makes monetary policy more effective.

There are a few examples of that. We looked at labour supply shock in early 2015. We looked at risks around China late in 2015. In this case, coming to the answer to your question, a discrete issue—membership or not of the European Union—has the potential to change trade off; we can come to how that might be. In a general election, as you well know, parties have myriad policies. There are a wide range of possible outcomes. The timing of those policies coming into effect can vary substantially, so there is not a discrete risk, positive or negative, that would be taken into account.

Q31 **Mr Rees-Mogg:** Is that really true? If you get a change of Government you get a change in policy and a change in market sentiment around it. If we had gone a year ago to the Labour Party's economic policy, that would have been a clear discrete event: a change of Government and a new Chancellor of the Exchequer, with a clearly identified set of economic policies.

Dr Carney: The precise constitution of a new Government, at the last election, could have been another coalition Government; it could have been a different coalition Government. The timing of certain policies coming in is an open question. This is your field. You know that actual policies do not always unfold in lockstep with a manifesto, and so it is too complex an alternative scenario to take into account.

Q32 Mr Rees-Mogg: This seems a very peculiar answer, because there is a great deal of complexity around whether or not we leave the European Union: the two-year period in which to negotiate how we leave, the uncertainty to what the outcomes will be, and what trade arrangements we would have. You are taking exactly the same speculation that you would be on a general election, and your answer so far is basically sophistry.

Dr Carney: No, it is not. In this case, there are identifiable impacts of this question, in certain financial asset prices, most noticeably in sterling; our analysis and our decomposition of that is detailed in the report, and it is adjusted. There are identifiable impacts on commercial transactions. We see it most notably, for example, in commercial real estate, but we see it in confidence indicators; we see it in business consumer confidence, which is adjusted. There are identifiable impacts that are consistent with the potential economic impacts of a decision to leave—the short-term economic impacts of a decision to leave the European Union. Those short-term economic impacts are relevant to the stance of monetary policy, and in order to make monetary policy more effective, it is important and useful to outline the potential effect on both growth and inflation, what drives that, the potentially offsetting effects and what that might mean for the stance of policy.

Q33 Mr Rees-Mogg: There have certainly been specific cases in the past when the Opposition's economic policy would have had a profound effect on sterling, and yet you would ignore those.

Dr Carney: Mr Rees-Mogg, the effect on sterling since November has been unusually—

Q34 Mr Rees-Mogg: No, I am asking you—

Dr Carney: No, I am answering, because the important thing is it has been unusually identifiable and related to the referendum.

Q35 Mr Rees-Mogg: I am asking you about a general election campaign in which not that long ago—in both our lifetimes—the Labour Party was suggesting reimposing capital controls. That would have had a profound effect on the exchange rate, and yet you are saying the Bank of England would never make a judgment on those.

Dr Carney: The point I have made is that in an election campaign there is are myriad policies, complexities and uncertainties about whether those policies are going to be put in place. What is unusual about this situation is that there is one policy. There is a discrete question, which is membership or not of the European Union. It is having identifiable effects on asset markets and on the underlying economy. We have to take those effects into account to make a judgment about the underlying momentum in the economy and the pressures on inflation, over the policy horizon, in order to make a policy decision. Those were judgments we had to make in order to make that decision on 12 May. We also recognise, individually and collectively, that the decision in the referendum could change

the monetary policy trade-off in a material fashion, and therefore change the stance of policy. It is important, not just for those in financial markets to understand that, but it is important also to come straight with the British people about that. That is what our remits require.

Q36 Mr Rees-Mogg: I am not convinced about that, but in the general election commonly—though not, admittedly, the last election—there are two outcomes: a Conservative or Labour Government, historically. There are myriad economic things that follow, as follow from potentially leaving, whether we have a Norway deal, a Switzerland deal, a Canadian deal, whether we have entirely free trade. All of these issues are uncertain and unsettled, and I think your comparison is essentially false. There is a usually binary outcome with myriad policies that follow from it, regardless of whether it is a general election. This is where you *seem to have become very politicised, and if I may move on, what conversations have you had with the Chancellor of the Exchequer in relation to our relationship with the European Union?*

Dr Carney: One point, if I may. I think it should be recognised that in any of those alternate trading relationships, there is likely to be some effect on the supply potential of the economy for a period of time. As a consequence of that, it complicates the monetary policy trade-off. There is a question of degree, depending on which deal could be negotiated, but with all of them, over the relevant horizon of monetary policy, that uncertainty is likely to have an impact on supply, so it is relevant and so that uncertainty—

Mr Rees-Mogg: Exactly the same applies to a change of Government. Exactly the same degree of uncertainty.

Dr Carney: I do not accept that.

Q37 Mr Rees-Mogg: Let us move on to your relationship with the Chancellor.

Dr Carney: The conversations that I have had with the Chancellor with respect to the European Union include a series of conversations around issues we discussed when I last appeared here, around how membership of the European Union affects the Bank's ability to achieve its remits, in monetary and financial stability. To grossly simplify, and I will not go into all of the detail, in terms of monetary stability ultimately we can achieve monetary stability, we can achieve the inflation target, whether or not we are a member of the European Union, under any sort of arrangement. That is clear. In terms of financial stability, there is—and we have talked about this at length—this positive aspect, which I think we have a slightly different view on, in terms of openness and dynamism in the economy. The challenge in terms of the negative aspect is in terms of exposure to risks in the euro area. Importantly, it is a question of whether we have the tools to achieve financial stability and how we can protect the necessary flexibility. There were a series of conversations with the Chancellor, as you would expect, about those issues in the run up to the negotiation of the so-called new settlement agreement.

Q38 Mr Rees-Mogg: And subsequently?

Dr Carney: Subsequent and antecedent to those, but more intensively subsequent to those, they have been about the economic implications. How is the economy doing, actually? Of course that is a regular ongoing conversation between any Governor and any Chancellor, and given that we are seeing manifesting some aspects of uncertainty and those effects on the economy, certainly the Chancellor is aware of our views on that. In terms of the potential economics of exit, yes, we have had conversations about that as well. As you would expect, and indeed as I am mandated under the remit of the Financial Policy Committee, if, as is the case, the Financial Policy Committee views the risks around the referendum as the biggest domestic risk, I am statutorily obliged to have conversations with the Chancellor around those risks, and I have done so.

Q39 Mr Rees-Mogg: Section 10 of the 1998 Act, and then section 4(1) of the 1946 Act, gives you independence in the field of monetary policy but leaves the Treasury open to give you direction in other areas. How do you expect that direction to come?

Dr Carney: In this day and age, one would expect that direction to come in a written form. Let me put it this way: I, as Governor, would demand—

Q40 Mr Rees-Mogg: You would not accept informal?

Dr Carney: I would not accept informal direction, no. On the issue of direction, if direction is to override a policy view of any of the committees, then one would expect it to be written and one would expect it to be public.

Q41 Mr Rees-Mogg: In terms of the information coming out of the Bank and the Treasury, has the Treasury known in advance of your publications?

Dr Carney: No. Well, here is what the Treasury knows every time we have an inflation report, or, for that matter, every monetary policy decision. There is a Treasury observer, as you know, on the Monetary Policy Committee. We have a written protocol with the Treasury, that that Treasury observer, who is normally the Second Permanent Secretary or of that stature, can brief two people in confidence: the Chancellor, obviously, and, if it is not the Permanent Secretary, the Permanent Secretary of the Treasury. That is understood. The Chancellor will know, if he or she chooses, the likely decision and the substance of that decision.

When we are 1% below or above the target, as you know, on a quarterly basis the Governor writes a letter to the Chancellor, as was the case in the most recent quarter. There is an exchange of letters. The Chancellor gets a draft of the letter in the public domain, and then responds to it. That is provided. That is the sum total of what is provided to the Treasury, so they do not see a draft of the inflation report and obviously they do not see the minutes, because we write the minutes and then put them up.

Q42 Mr Rees-Mogg: In your discussions with the Chancellor about the whole issue relating to remain or leave, have you kept minutes of those meetings?

Dr Carney: No.

Q43 **Mr Rees-Mogg:** Or of telephone calls; do you have notes? Are notes kept by your team or the Treasury team that you are aware of?

Dr Carney: I do not think I have had a telephone conversation with the Chancellor on these issues.

Q44 **Mr Rees-Mogg:** Are there other officials in those meetings?

Dr Carney: There are other officials, and I am sure that we have minutes, yes.

Q45 **Mr Rees-Mogg:** Would there be a possibility of publishing those, so that we can see?

Dr Carney: It is not the norm to publish those minutes.

Q46 **Mr Rees-Mogg:** This is highly politically sensitive, and to see that there has not been undue influence coming from the Treasury—

Dr Carney: There is no possibility of undue influence coming from the Treasury. I am appointed for one term.

Q47 **Mr Rees-Mogg:** There is always a possibility.

Dr Carney: There is no possibility of undue influence. There is no possibility of effective influence, even if it had been tried.

Q48 **Mr Rees-Mogg:** It is very convenient that you are giving out exactly the same propaganda as the Chancellor.

Dr Carney: I do not accept that at all. I do not accept that at all. Mr Rees-Mogg, the judgments in the monetary policy summary, in the minutes, in the letter to the Chancellor, and in the inflation report—those judgments around the risks around the referendum, both actual, that are manifesting in the economy today, and prospective, in the event of a vote to leave—are the judgments, individually and collectively, of the nine independent members of the Monetary Policy Committee.

Q49 **Mr Rees-Mogg:** In a deeply political area where you would not, in a general election, give a view, where you have gone away from the normal independence of the Bank of England—

Dr Carney: This is not a general election, Mr Rees-Mogg.

Q50 Mr Rees-Mogg: I am aware of that, but it is still a popular vote across the country. As the Prime Minister has said, it is more important than a general election, which happen every five years.

Dr Carney: We have a responsibility to discharge our remit, and we have a broader responsibility to the British public, who do not want risks kept hidden from them. They expect us to come straight with them about the issues, and they expect us to take action to the extent possible to mitigate those risks, and that is entirely right.

Q51 Mr Rees-Mogg: Do you not have a responsibility to be apolitical?

Dr Carney: We are apolitical.

Mr Rees-Mogg: As soon as you become political, when you support one side in a campaign, why should anyone now trust you to set interest rates other than for the benefit of the Government?

Dr Carney: Mr Rees-Mogg, we have not supported a side in the campaign. The only side we have supported is the pursuit of low, stable and predictable inflation, which is our remit. By our actions and by our commentary, which may be inconvenient for you, we have made it more likely that we will bring inflation back to target, whatever the outcome of the referendum, sooner and more sustainably, and that will be a better economic outcome. That is our contribution to a better economic outcome for the British people, and to suggest otherwise is to try to undermine that.

Mr Rees-Mogg: I do suggest otherwise.

Dr Carney: And so you try to undermine that.

Q52 Mr Rees-Mogg: I think you have become politically involved in a way that you have quite clearly said that you would not in a general election. Jeremy Corbyn has given an important speech on economics a few days ago. The MPC has not given a view on whether his new economics is a good idea or bad idea, and I assume will not.

Q53 Chair: Do you want to answer that at all?

Dr Carney: I do not think it is worth replying to.

Chair: Is there anything more you want to ask?

Q54 Mr Rees-Mogg: Yes, I just want to ask one thing. Is it the case that you agreed to speak to wavering MPs about how they should—

Dr Carney: No, it is not.

Q55 Mr Rees-Mogg: Is that not correct?

Dr Carney: That is not correct.

Q56 Mr Rees-Mogg: That was reported to me. I just want to finish on the opening point and the damage this does to the Bank of England's reputation, because the Bank of England has had a very high reputation since it got independence to set interest rates, on the basis that depoliticising it would mean that it would not be set for the electoral cycle. Getting involved in the details of something that is actually more fundamental than an election campaign fundamentally undermines the standing of the Bank of England and its appearance of independence, and it appears that the Bank of England has become a creature of the Government.

Dr Carney: What you have missed in that is that there is an issue that has an impact and is having an impact on the economy, and has a prospective impact on the economy in a way that affects our ability to discharge our remit. It is political to ignore it. It is political to take a decision not to disclose. If we are changing policy, as the Bank of England has—we have changed our liquidity policy, we have changed our supervisory policy, and we might have to change our monetary policy in pursuit of our remit—we have an obligation to disclose that.

Q57 Mr Rees-Mogg: All of that applies to the economic policies of an opposition party.

Dr Carney: I cannot think of a case, Mr Rees-Mogg, where the Bank of England has changed any of those policies in advance of a general election, and yet we are in that circumstance with respect to this vote.

Chair: What these exchanges are illustrating is the fault line on which the Bank has sat since independence, since 1997, with respect to a whole heap of potentially controversial and highly political issues. I can say that the view of a large number of members of this Committee is that a vow of Omertà from the Bank of England on this subject would have resulted in a bumpy hearing or two for you and your colleagues in front of this Committee in the face of a decision or an event of this type.

Q58 Rachel Reeves: If anyone's reputation has been damaged there, I do not think it is the Bank of England's. It seems to me that the Bank has a clear remit and must look at the factors that affect inflation, and it is the responsibility of yours to put that information in the public domain in the interests of transparency.

Q59 I have some questions about interest rates and inflation in the event of us leaving the European Union. In recent weeks, the Chancellor has been suggesting, for example at the IMF spring meetings, that interest rates would rise following a leave vote. He said, "The overwhelming view of the experts here in Washington is that if Britain leaves the EU, prices would go up and there would be instability in financial markets", and "that means it's likely that mortgage rates would go up". Has the Chancellor discussed that with you, Governor, and is that your view?

Dr Carney: We have discussed potential developments on risk premia on sterling assets. For both of our direct responsibilities, that risk is relevant. I would characterise it thus: the combination of the effects on demand, supply and the exchange rate—I will simplify; I know you understand all of this—could result in either a lower or higher Bank Rate. What

is more likely, where I am on surer ground, is that there is likely to be risk premia on risky assets, in UK sterling assets, for a period of time. Even in the case of a potentially lower Bank Rate, the overall mortgage rate could be higher. That is certainly a possibility. Obviously in the case where Bank Rate had to stay at its current level, or even higher over time, because of inflationary pressures through those three countervailing forces, it would be higher still, so it is a possibility.

Q60 Rachel Reeves: So it would be consistent to say that Bank Rate may stay the same or even lower, but at the same time you could have a higher mortgage rate because of the risk premia?

Dr Carney: Yes, and to put a finer point on it, it is not unreasonable to expect term premia on UK assets to increase from the relatively low level, and those are more relevant for mortgage rates.

Q61 Rachel Reeves: So further along the yield curve.

Dr Carney: Further along the yield curve, yes.

Q62 Rachel Reeves: You would have higher rates. Thank you. In the minutes from the last MPC meeting, it said, “The MPC would face a trade-off between stabilising inflation on the one hand and output and employment on the other. The implications for the direction of monetary policy will depend on the relative magnitudes”—which is what you have said—“of the demand, supply and exchange rate effects”. Following the outcome of the referendum “the MPC will take whatever action is needed to ensure that inflation expectations remain well anchored and inflation returns to the target over the appropriate horizon”. Compared to the minutes the previous month, that seems to be a strengthening of the language, and suggests to me—and maybe I am wrong, and I seek your clarification—that a rate rise is more likely than you were suggesting the previous month. Would that be correct?

Dr Carney: I would not necessarily conclude that. What I would take is that the difference between the minutes and the report in May versus the minutes in April is that the analytic basis of the conclusion is much stronger. In other words, we did a formal forecast and then we did a fairly extensive risk analysis around that forecast, the risk analysis being a vote to leave, which confirmed our economic intuition. As you know, we use a lot of “could”, “would”, “should”, “likely to” and “expected to”, as Dr Weale pointed out earlier. I will leave it at that point, which is that the analytic force and the degree of discussion and debate we had around that conclusion was much higher in May than it was in April.

Q63 Rachel Reeves: You mean you had more debate about it?

Dr Carney: We had more debate, but staff did a lot more analysis. We went through, in the box towards the end of section 5 in the inflation report, those economic drivers in more detail. There is other analysis underlying those words.

Q64 Rachel Reeves: Dr Broadbent, did you want to add anything?

Dr Broadbent: No, I think the Governor is exactly right. It simply reflects the fact that we had done some more thinking and had some more work done on this question. I do not think there was any shift, as it were, in the central opinion about what the effect of this might actually be on interest rates.

Q65 Rachel Reeves: I guess I have two questions, then. At the moment, and not knowing the result of the referendum, do you think the next rate rise is more likely to be up or down? My second question is, if the referendum was a leave vote, do you think the more likely move would be up or down?

Dr Carney: The view of the committee is that rates are likely to be higher at the end of the forecast horizon, so three year from now, than they are at present. My personal view is that the next interest rate move is more likely to be up than down in a remain vote. I will draw attention to this point about where the underlying momentum is in the economy. It is much less clear, given the sharp deceleration we have seen at the same time we have seen the spike in uncertainty. In the event of a leave vote, I do not know but I would like to hold to the language we used, which is that there are these countervailing forces. It is not a straightforward decision. Even though the economy is likely to slow materially, it is not clear that the correct response from a monetary policy perspective would be to ease into that slowing, because of the likely increase in inflation, nor does it follow that we would necessarily tighten policy. We would have to get a read pretty quickly about the relative scale of the slowdown in demand, prospective slowdown in supply, and the exchange rate move.

Q66 Rachel Reeves: So, Dr Carney, you think that if we remain, the next interest rate move is likely to be up, and probably, on balance, if we left that would be the same?

Dr Carney: No, on balance it would reduce that probability. Let me put it this way: financial markets, understandably, have an almost pavlovian response to bad news. It is learned behaviour since the fall of 2007. Any time anything bad happens, the central bank eases policy. That is the sense. In this case, because the exchange rate may do a lot of the work—maybe too much of the work; that is a risk—and because there is potentially a supply shock, actual or perspective, and that would put upward pressure on inflation, both of those aspects would mitigate against stimulus, so would reduce the likelihood or the degree of stimulus that would be appropriate, despite the fact. It is a slightly complicated point to get across, but it is an important one, and if I may it is a useful line of questioning because this is part of what we are trying to draw out in the risk scenario: that it is not as simple as the economy slows and so rates get cut. It is not that simple.

Q67 Rachel Reeves: What you are suggesting, Dr Carney, is that in the event of us leaving the European Union, you are likely to see a depreciation of sterling and a supply shock, that would both put upward pressure on inflation and that would make it harder to reduce rates even if the economy was slowing?

Dr Carney: Yes, that is correct.

Q68 Rachel Reeves: Dr Vlieghe, Dr Broadbent and Dr Weale, do you share that analysis?

Dr Weale: Of course, as was implicit in what the Governor said, what matters is the relative magnitudes, and immediately after the referendum we will know what has happened in financial markets, including what has happened to the exchange rate. Of course, we probably will not have any good sense of where the exchange rate is settling. We will just, perhaps, be getting some indications of whether there has been a substantial impact on demand, and as to the impact on supply, as we often do, we will have to form our own judgments, because we will not have any data to go on. That is, of course, the nature of monetary policymaking, but, at least for the time I continue to be involved on the committee, it will be a question of looking at the numbers as they emerge and deciding what the appropriate response is. As the Governor says, there will be effects pulling in opposite directions.

Dr Broadbent: I agree with all of that. The only thing I would add is that we learn things about supply over time, for example from looking at the behaviour of unemployment and employment, but it takes longer to learn those things than it does to see immediately what is happening to aggregate demand.

One other thing, just quickly, is that, as the Governor pointed out, it is apparent to us that the economy has slowed quite a lot through the course of this year. We think at least some of that is due to the uncertainty created by the referendum itself, even in advance of the decision. Quite how much is due to that, quite how much is due to something else that might persist even were we to remain in the EU, is unclear. If it were to persist then the calculation about monetary policy would also change, as it does in the normal course of events.

Q69 Rachel Reeves: In your view, in the event of a remain vote and a leave vote, do you share the Governor's view that the next interest rate move is likely to be up in the event of a remain vote, and up with a reduced probability under an exit vote?

Dr Broadbent: One of the virtues of being on this committee is that we set interest rates in real time, as and when it happens, and we do not have to make precise predictions. This is an entirely personal view, because each of us on the committee has his or her own view, but because of what I just described about the slowing of the economy, if anything I am less certain of that than I was six months ago.

Dr Vlieghe: What I point out in the scenario for a remain vote is that the UK economy has been doing reasonably well over the last few years, but it has been losing momentum. It has been losing momentum for a couple of years now, quite gradually, but if you go back a

couple of years and see what we expected to happen to the economy then, and see what actually turned out, it is quite a big downward revision to both growth and inflation. The point I have already made a few times but continue to emphasise is that if that pattern continues, where we keep having to revise that down, then at some point it will be necessary to give the economy some monetary stimulus, to make sure that the momentum does not slow any further, and we do get the inflation back to target. Very recently, for the slowdown in the last few months, it is more likely than not that was due to uncertainty ahead of the referendum, and therefore after the referendum, in the case of a vote to remain, I would expect to see all these deferred spending decisions come back on and people spending the money after the referendum. It might then not be necessary to add stimulus to the economy, but the point I have made is that if we do not see that reasonably soon after, I will conclude that actually the slowdown was due to other factors and there was not as big a referendum contribution.

Q70 Chair: What are the key factors that lead you to the conclusion that it is more likely than not to have been caused by the referendum?

Dr Vlieghe: There are two different lines of argument. One is a direct, positive identification, and the other one is more of a by-omission identification. The direct, positive evidence is that we have seen, as we approach the referendum date, certain types of activity drop off quite sharply, specifically in the UK and nowhere else. For example—we have talked about this in the report and the minutes—we saw a very sharp drop in commercial real estate transactions. If you go and speak to lots of financial companies that do advisory and transaction-type work, lots of them have said to us, “We are not doing any business because everybody wants to wait.”

Q71 Chair: There has also been the small matter of the stamp duty reform.

Dr Vlieghe: There is that as well. I am talking now about business activity. We have lots of intelligence that people have stopped and said, “I have a meaningful transaction I have to decide on. It just makes sense to wait a few months and see how the referendum turns out, and then I will do it.” That causes its own slowing. That is an active identification. There are a number of indicators that point in that direction. The other thing is, simply if you look around our major trading partners, the eurozone has done quite well in the first quarter—a little better than expected—and is expected to do reasonably well again in the second quarter. The US had some erratic influence in the first quarter, but is looking like it is gaining momentum in the second quarter, and so the UK stands out as the only one that had this sharp slowing, which then makes you look for a UK-specific explanation. The obvious one is uncertainty around the referendum.

Q72 Rachel Reeves: Finally, I just wanted to ask something about the Treasury analysis published yesterday. The Treasury analysis had four key mechanisms by which an exit vote would impact the economy, through uncertainty, confidence, depreciation of sterling and tighter financial conditions. Would you agree, Dr Carney, that those are the main ways in which an exit vote would impact on the

economy? Are they the main transition mechanisms? Are there others that we should look at too?

Dr Carney: If I may, rather than compare to the Treasury document, I would say that we see uncertainty as a potential driver, and the impact of uncertainty on both consumption and investment. Dr Vlieghe just gave one example, which, if I may, Chair, was commercial real estate, not residential real estate. Secondly, we would see sterling and likely overall financial conditions tightening. We have talked about risk premia on UK assets likely going up.

The more challenging element—and Dr Weale highlighted the difficulty of judgments around this but the direction seems pretty clear—is that there would be an impact on the potential supply of the economy. There would be capital stock, which is relevant in certain trading scenarios but less relevant and less effective in others and needs to be reallocated. The uncertainty would likely drive reduced investment, as I mentioned, for a period of time, which would ultimately have an impact on productivity over that period. There is then a question at the end of the forecast horizon—which is three years, so beyond the two-year negotiation period, depending on when it is triggered—of what the new terms of trade are for the economy and the impact of that on supply in the economy. That is an important element. If I may finish with this, one of the questions for demand is not just a question of how people respond to a more uncertain environment, but also the extent to which they can look forward and recognise the likelihood, or at least the possibility, that their incomes will be lower for a period of time because of the supply effect.

Q73 Rachel Reeves: Just finally finally, the Treasury report suggested that the impact would be inflation about 2.5% higher than it would otherwise be, GDP between 4% and 6% lower, and job losses of about 800,000 or so in a severe shock scenario. Do those conclusions sound reasonable to you, Dr Carney?

Dr Carney: If I may, I do not think it is our role to audit or validate the Treasury report. The Treasury can speak for itself. I do note Sir Charlie Bean has reviewed it. Our bottom line is that there is likely material slowing in growth and likely notable increase in inflation, and the issues that you have been drawing out around the trade-off, so I would stick to that.

Q74 John Mann: Dr Weale, you have been on six years now. Dr Vlieghe, you are fairly new. I will ask a question of you two, if I may. The implications of the attacks on the Governor, both in this Committee today and in public by leading politicians, is simplistically but accurately put that the Governor is taking his instructions from the Chancellor, and he has been quizzed at length today on whether there are minutes and recordings. There is another implication of that attack, and that is that you two and the other externals are complicit and that you do whatever the Governor tells you to do on all matters, regardless of merit. Why are you so quiet in not defending your reputation? Dr Weale, you have been on six years.

Dr Weale: Yes, I have been on for six years. I suppose I ought to suggest that you ask the Governor whether he thinks I always follow his instructions. If you look at my voting record, it is clear that I have publicly expressed my own views when they differ materially enough for that to lead to a difference in voting from the majority and indeed from the Governor. I have expressed my views in more nuanced ways when there are differences of emphasis that do not nevertheless lead to differences in vote. As far as I can see, what I have tried to do is to describe things as I see them—

Q75 John Mann: My question is slightly different to both of you. Why are the externals not kicking up an almighty stink that you are independent and you are not instructed by the Governor, even less by the Chancellor? This is either a stitch-up on the British people, in which you are complicit, or it is an outrageous allegation and a slur on your integrity. It is one or the other. Should we not be hearing the voice of the externals defending a) yourselves, b) the roles of externals, and c) the whole concept of what is described or what we voted through as an independent Bank of England? Should you not be the ones taking the lead in saying, “This is nonsense”? Dr Vlieghe?

Dr Vlieghe: I do actually resent the implication that we take instructions from anyone—the Governor or the Chancellor. We are all individually accountable. That is one of the reasons why we are here. I can tell you very firmly that nobody has told or asked me about which way these discussions should go. All that happens is a draft is sent out, where it says, “We suggest that the following issues should be discussed”. We have an opportunity even to revise the agenda, and say, “No, actually I would like to put other things on the agenda”. We then have the discussion and each member of the committee says exactly what they think, and at no point is there any insinuation that that is not—

Q76 John Mann: I understand that, but, with respect, my question is why you externals are not out there more vigorously defending the Governor, if the Governor is independent and if you are independent. I am not hearing this, and have not been hearing this, so I am asking almost what the point is of externals if you are not out there defending the integrity of the institution you have been appointed to.

Dr Weale: The point of the external members is very much as I described: to express our own views in public, to this Committee and at other public occasions; and to describe things exactly as we see them. Certainly the volume has turned up on the issue that you mentioned, but throughout the time I have been on the Committee there have been the suggestions that the Governor fixes the interest rate, which he does not. Mervyn King used to complain about newspaper headlines which said, “King changes interest rates”. People have then suggested, for example, when the Bank Rate was reduced, as it has been staying low, that is because the Chancellor has leant on the Governor, who has then in some mysterious way suppressed the voting of the Committee. The volume has turned up on this, but it has been an undercurrent throughout my time on the Committee, and in June of last year I did set out very clearly the way in which I understood the Monetary Policy Committee to work and the way in which I thought independence worked.

Q77 John Mann: May I make the suggestion, not of the Governor but of the externals, that if what you are saying is that you are independent, that you do not follow the instruction of the Governor and that you do not follow the instruction of the Chancellor, and you are party to the things that have come out where this has been alleged, that it would be appropriate that your voice is heard, and further, if you do not do that, that does suggest in some way that you are doing whatever the Governor tells you to do, for better or for worse, whether he is influenced by the Chancellor or not? If you are independent you need to be, as a group of independents, speaking out now, pointing out your independence, how it works and why it works.

Dr Weale: I cannot accept your last point. Simply by the fact that 10 days ago I talked about issues of uncertainty, a text that I tried to put together that I hoped would be interesting for my audience, I cannot accept for one moment that the fact that I did not refer to my independence there meant I am complicit in what you describe.

Dr Broadbent: Mr Mann, do you mind if I say something as well? Believe it or not, even I am independent. It is not just the externals. I feel similarly resentful, like Dr Vlieghe, and I must say even at the start, Chairman, when you described this as “an intervention” in the debate, that is not the way I see it at all. What we are intervening in is our normal business of monetary policy and the risks to that policy. That is what we are intervening in. There is no deliberate decision on any individual’s part or the collective part to intervene politically. It is very much our turf, and that is why we did it. I think the same applies to everybody else, and I certainly do not take instructions either from the Governor, whether through him or directly from the Chancellor.

Q78 John Mann: What is the difference between the Bank’s analysis and the Treasury analysis that has just been published? What is the key difference between the two?

Dr Broadbent: I have not even looked at the Treasury analysis that has just come out, either before or since.

Dr Carney: If I may, I will draw attention to one thing that I noticed last evening. It appears to me that the way the inflation profile is in the Treasury analysis, an increase in inflation comes in more sharply and then fades more rapidly than I would expect it to. Over the last couple of years, we have done a lot of analysis on exchange rate pass-through. What we have learned from the post-crisis experience, the recent analysis we have done and the experience of the strength of sterling up until recently has been that pass-through in the UK tends to be more protracted. The reason I am raising this, Mr Mann, is that it is relevant to the line of questioning that Ms Reeves had. It is because it is more protracted and because it is likely to extend over the monetary policy horizon that creates the challenge.

Q79 John Mann: As the only undeclared Member in Parliament, by the way, I have not yet received an invitation to this private briefing that Mr Rees-Mogg alluded to. I can make myself free around the time of the next test match. I have one final question. I have just been in Switzerland and Liechtenstein talking to the

bankers' associations and others on tax avoidance and other matters. I noted, as was pointed out to me, that the EFTA countries have had to implement 4,500 pieces of legislation in the last 10 years, all from the European Union. The biggest single department in the Government of Liechtenstein is the department that deals with issues related to European regulations that they have to abide by. That got me thinking that you have a lot of staff who are dealing with these matters and monitoring them. Are you intending to change the number of staff that you employ in the Bank dependent on the result of the referendum, or could we anticipate that the same number of staff will be required to deal with these complexities from the European Union regardless?

Dr Carney: The resources of the Bank of England would entirely depend on the arrangements that were negotiated. Whether it was an EFTA relationship, a WTO relationship or a special side deal on financial services, it would be entirely dependent on that, so we have no plans yet, because it is uncertain what the result would be and what it would lead to.

Q80 Chair: Governor, you said a moment ago that you have started to notice a few differences between the Treasury document and your own analysis. Did you see or did Bank staff see any aspects of this document in draft? Did they have any discussions about it prior to its production?

Dr Carney: It is a Treasury document, to be absolutely clear. The Bank staff have not seen it, did not comment and did not participate in its development whatsoever.

Q81 Chair: The first you saw of this was the moment that we saw it.

Dr Carney: I am getting to that. In advance of seeing the Chancellor two weeks ago, I saw an early draft, because of the economics underlying it.

Q82 Chair: You must have been briefed on that and shown some differences between that and this.

Dr Carney: What is interesting is that it was not developed and so, for example, it did not have the full forecast. The point I just raised, which is the main thing that I took from it—and just to be absolutely clear, I am not making any comment about the orders of magnitude or anything with respect to the draft.

Q83 Chair: I am just asking whether you saw it. You did see it a fortnight ago and your staff briefed you on it.

Dr Carney: No, my staff did not brief me on it.

Q84 Chair: They sent it to you and your staff took a look at it.

Dr Carney: No, I looked at it personally. I did not give it to my staff. I looked at it personally. I had breakfast with the Chancellor. We were talking about two things: contingency planning and economics.

Chair: He pushed this across the desk to you.

Dr Carney: Yes, I looked at it for my initial reaction—no formal comment, nothing. Their document comes out and it is what it is. Others will judge its merit. Charlie Bean has made his judgment. The main point I took in response to Mr Mann’s question was that the biggest thing that jumped out at me was just the inflation profile, not surprisingly, because as a central banker the first thing I looked for was the inflation profile, because that is what is relevant to us, in terms of discharge.

Q85 Helen Goodman: I am delighted that my colleague Jacob Rees-Mogg has endorsed the Labour policy of an independent Bank of England. Do you remember that, on the day the inflation report was published, you were also criticised, Dr Carney, for encouraging people to short the currency. I noticed that, in fact, the exchange rate rose 2 cents in the subsequent three days. Do you have any views on why that might have been?

Dr Carney: The first thing I would say is that, on the day of the inflation report’s release and the press conference, Dr Broadbent and I were there with Dr Shafik. The reaction of the financial markets was mild. It was one of the least volatile days, the least reaction to an inflation report. Sterling appreciated mildly on the day. Interest rate futures did not really move around very much. From a market perspective, it was not a big event. In addition from a market perspective, the possibility of a sharp depreciation of sterling, that observation, is not a surprise, because the market is as short sterling as it has ever been in the options market. The purchase of downside protection in the options market relative to protection against sterling depreciating is quite sharply skewed. It has come back a bit now. The market is positioned for a depreciation of the currency, in the event of a leave vote. The economics point in a similar direction.

Why exactly sterling moved up in the subsequent few days I will not hazard too much of a guess, for short-term moves. I will note, as we did note in the inflation report, that we can identify a referendum effect on sterling since November. It has moved with relative probability of a leave vote.

Q86 Helen Goodman: You have said again what you said in report—that there could be “a sharp decline” in sterling. Why did you use the word “sharp”? Do you not think that that is a rather alarmist way of describing it?

Dr Carney: It is a realistic assessment of the prospects. It is something that we discussed as a committee, both the economics, the fundamental value in the event of a move, and also positioning in financial markets. From where sterling had gone since the prospect of the referendum came into sharper relief and the relative probability of a leave vote, one can judge orders of magnitude of how the market thinks the exchange rate will move. That order of magnitude is sharp.

From a central bank and risk management perspective, first off, it is relevant for achieving the inflation target, so the observation needs to be made. If it were not a material move in sterling, one would not need to make the observation. It would not be relevant. Secondly, it is also relevant—and this is slightly reflexive—that the market knows that we know. To deny it is not to remove the risk. Thirdly, what is also important is that the market understands, as per the earlier exchange with Ms Reeves, that it is not automatic that a slowing in growth would lead to a substantial easing of policy. Those expectations around the path of policy would potentially further influence the path of the currency.

By recognising and bringing out those dynamics, the feedback mechanisms help contain and increase—not guarantee, but increase—the probability that an adjustment in the exchange rate is appropriate to the underlying change in economic circumstances, which is what we all want, not overshooting or misunderstanding. The worst case is overshooting because the market misunderstands how the MPC could react to those changes in economic circumstances.

Q87 Helen Goodman: I think you have put your finger on it there. I was going to ask Dr Broadbent about what he said to the press in the panel that you had on the 12th. I think you said that you would expect, in the event of a Brexit vote, movements to be more than 3%. In something called chart B—options prices pointing to a risk of a further sterling depreciation following the referendum—it looks very much like a 3% fall. This is something from the inflation report, page 5. So it seems as if you may be considering the possibility of falls in sterling that are greater than those that one would infer from what is in the markets at the moment, or am I misunderstanding?

Dr Broadbent: What this analysis suggested to us was that close to five percentage points of the 9% decline we have seen in sterling since November was attributable not to the fact of exit, but to the possibility of leaving the EU. We attributed it to the rise in the perceived risk of leaving. That risk is not 100% at the moment. Roughly speaking, this might have been caused by, say, an assessed probability in the market at the time of around 30%. If it were to go from 30% to 100%, which is what happens in the event of a leave vote, one might infer that you would have more than another 5%. That was one of the bases on which I made that point.

I would also refer to what the Governor said a moment ago, which is that you look at the actual movements in sterling—this is one of the things that informed this estimate—and how they have responded to changes in the perceived probability of exit, which one can infer from betting markets and the like—

Q88 Helen Goodman: Is that what the Bank does?

Dr Broadbent: It is one of the things that inform it. We looked at a number of things, such as news around the referendum.

Helen Goodman: Do you go to William Hill? I do not know.

Dr Broadbent: You find similar orders of magnitude. Changes in the perceived probability have a particular impact. That was one of the bases on which I made that remark, and then I also talked about some of the economics that might underlie that judgment that the markets appear to be taking.

Q89 Helen Goodman: You did indeed. That is true. What we have here is a slightly different approach, in terms of not just using what the market rates are. Do you think that this will have any impact on the way the Bank's forecasting is viewed in future—the fact that you have changed practice slightly on this occasion?

Dr Broadbent: We have two normal conventions. There are probably more than that, but I will pick out two. One is to assume that Government policy is followed. These are just the conditioning assumptions for the forecast. The other, as you say, is to take the prices of all assets, exchange rates and forward interest rates, as given from the market. In principle, those two things are not necessarily aligned, because the markets might attach some probability to Government policy changing. There might always be some degree of tension.

In this particular case, our view was that there was a lot of tension. It was clear to us that a good part of the behaviour of the exchange rate and a good part of its decline over the last six months related quite specifically to the likelihood that Government policy would change, in particular that we would leave the European Union. If we had done nothing and made no adjustment to the conditioning assumption for asset prices, there would have been a pretty clear and important inconsistency between those two things. That is why we made the adjustment to the conditioning level of the exchange rate. Is it something we would normally do? No, I hope not, because I hope that there are not such glaring inconsistencies between the two sorts of assumptions we made, but one cannot rule it out.

Dr Weale: I simply wanted to make the point that, if you look on page 40, we do provide a table showing what the forecast would have been if we had not treated the effect of the exchange rate in the way that we did.

Q90 Helen Goodman: I would like to ask a couple of questions about asset prices. You were pointing out what is happening in the real estate market at the moment, but that does not seem to be reflected in the inflation report, in the commentary on asset prices. Is that a fair comment from me?

Dr Vlieghe: No. Actually, there is quite a detailed discussion of what I said about commercial real estate.

Q91 Helen Goodman: It is not feeding through into other assets like equities. You are seeing this as very confined—what would the word be? It is affecting the property market, but there does not seem to be any linkage into other markets.

Dr Vlieghe: No, that is not necessarily the case. We have talked about the things that we can readily identify and that is one of them—a big drop in transactions and even some weakness in prices. When you move to analysing equities, the difficulty of unpicking it is

that one approach that some people use is to say, “Let’s focus on the share prices of companies that focus most of their business in the UK, against companies that focus most of their business outside the UK and try to see if there is a differential between the two.” The difficulty with that is that the exchange rate is moving around a lot. Other things being equal, a drop in the exchange rate causes an export-orientated company to have better share price performance than a domestically orientated company. Therefore, we tried to see if we could find a referendum effect, but it was not easily identifiable in equities or in the yield curve, but we did find it very clearly in the exchange rate. We tried across all the assets.

Q92 Helen Goodman: You found it in the exchange rate and the real estate market.

Dr Vlieghe: Yes.

Dr Carney: If I may, there is underperformance of UK-focused equities relative to globally focused, so FTSE 250 versus FTSE 100. As Dr Vlieghe just said, if you were hedged for the currency move, most of that would go away. Part of what appears to be happening in equities markets, which also helps explain the options hedging, is that international investors who are exposed to UK equities are hedging a bit with the currency, depending on relative probabilities. I would observe that it appears there is some evidence, but you cannot be too definitive, and I refer to a Merrill Lynch survey of major institutional investors, that they are as underweight UK equities at present as they have been since 2008. That is consistent with anecdotal and other discussions that we have had and would be consistent with relative performance.

Q93 Helen Goodman: I was just going to ask Dr Weale about his speech the day after the inflation report, where he discussed the risk that the MPC could lose control of inflation, if it had overestimated the degree to which the referendum has weighed on sterling. You said you would feel as if “history was repeating itself”. What exactly did you mean by that?

Dr Weale: As events have developed, I was thinking that the judgment that we made about the effects of the referendum uncertainty on the exchange rate seemed to be, if anything, confirmed by the movements we have seen in the last few days. What I was thinking of was the possibility that the exchange rate would stay where it was when we produced the inflation report and that it would not rise in the event of a vote to remain. As the table I drew your attention to on page 40 showed, that would lead to an inflation forecast materially above the target.

I suppose that took my mind back to my early days on the committee, when the economy looked weak and it looked, to me at least, as though inflation was likely to remain above target even at the two-to-three-year horizon. Of course, inflation did come back to and below target, but it is not a terribly comfortable situation for a policymaker to be in because, on the one hand, you have a weak economy that looks as though it needs support. On the other hand, we have the inflation target. While the remit allows us to make trade-offs, to explain the judgments behind them and to allow inflation to deviate from its target temporarily, nevertheless there is the inflation target.

Q94 Helen Goodman: It intensifies the policy dilemma.

Dr Weale: Absolutely, yes.

Q95 Helen Goodman: If sterling does not bounce back in the event of a referendum that will be a permanent impact on the economy of simply having had the referendum.

Dr Weale: Not necessarily, no. I think the referendum is a particular case, where we have been able to identify particular influences on the exchange rate with a reasonable degree of confidence. Quite often, or most of the time, exchange rates move and you cannot say with any degree of precision what it is that is moving them.

Q96 Mr Baker: Before we go any further, I would like to say that I am going to positively reject the idea that you are wicked conspirators. I am going to say that I choose to believe your wholesome innocence, completely unsullied by the grubby politics of this referendum matter. As you know, I think you are just generally wrong and I hope you will come to the IEA Hayek lecture on 8 June to hear George Selgin set out in some detail why. Governor, you seemed keen at the beginning to briefly indicate how dreary your Mansion House speech will be. Could you briefly put that on record?

Dr Carney: It was just in the spirit of transparency. It is important given the topic. As you know, it is a major event. It falls in referendum purdah, as we are interpreting it. It would obviously be inappropriate to give a speech about aspects that touch on aspects of what we are discussing. My speech will be about aspects of FinTech and distributed ledger technologies. It starts to shift into areas that interest you, Mr Baker, in terms of broader application of what it can mean for the structure of the financial system and what the Bank of England is doing or should do to enable it to start a broader conversation about those issues.

Q97 Mr Baker: May I stop you, because this has already become a happier occasion than I expected? You may know that the Bank of England kindly supported the conference that my think-tank just held at the European Parliament, so thanks very much. You mentioned that the IMF's intervention just before the poll would be a sort of technical detail, but you must be aware that you personally have been co-opted into the remain camp in the literature, against your will. I remember sitting here with your photo on a leaflet with a quote underneath, so surely you must understand that when you or the OECD or the IMF or the Governor or the Prime Minister speaks, it will be co-opted on to one side or the other of the debate, if it is helpful to that cause.

Dr Carney: Somebody showed me yesterday that an analysis of the Treasury report used comments I made and comments I stand by, from the leave campaign, to challenge aspects

of the Treasury report. I recognise that. All we can do is just call the economics as we see them. Our words and analysis will be used by both sides and that is fair game.

Q98 Mr Baker: Perhaps I could just restate some of the things that have been put to you before about the IMF. Would you concede that it would be better if the IMF, the OECD and others spoke in such a manner around this referendum period that they were clearly demonstrating, witnessing if you will, that they understand that whatever they say will be co-opted into the campaign?

Dr Carney: They should take due care with their comments, yes. The IMF has a lot of experience. It does not always get it right though, but it has a lot of experience.

Q99 Chair: They seem to have done pretty well at getting it wrong for a sustained period about the UK.

Dr Carney: I do not comment on fiscal policy.

Q100 Chair: You could just say “yes” to that, as I could tell you were at the point of doing.

Dr Carney: They have made some errors about the UK. You have forced it out of me, yes.

Q101 Mr Baker: On this point of uncertainty, I know that you are well aware of your ability to influence economic expectations. Indeed, it underlies not only various speeches but the experiment, if I may call it that, in forward guidance. In the report, it describes how occurrences of media reports of the referendum are one of the factors you take into account when measuring or trying to quantify uncertainty. Would you concede that, given the institutional interventions around this time from the Prime Minister, the Chancellor of the Exchequer, yourselves, the OECD and the IMF, there is a good possibility that big players in the economy are actively promoting economic uncertainty by their interventions?

Dr Carney: I will speak for the Bank of England. We are seeking to do the exact opposite, which is to reduce the uncertainty that individuals, companies or financial market actors could have about our commitment to the inflation target, what we would do in different scenarios and what it could mean for the path of interest rates but, most importantly, for the path of inflation and our commitment to bringing inflation back to target and to keeping it there. The purpose of an inflation report is ultimately to describe and support the stance of monetary policy in pursuit of that remit.

Q102 Mr Baker: Would you accept that if the Prime Minister and the Chancellor, instead of saying what they are currently saying, were to say that, for example, for those 43 years, the course of public policy has been to align the United Kingdom’s environment with that of the European Union and that, therefore, we would expect a smooth transition into a different free trading arrangement; would you accept

that, if they were to say that, it would have a materially different set of influences on expectations and uncertainty?

Dr Carney: To be slightly glib, if they were to say that now, it would add to uncertainty, because it would be inconsistent with what they had been saying.

Q103 **Mr Baker:** For example, Andrea Leadsom has said that. She is a previous City Minister. If people were to listen to Andrea Leadsom, do you not think that they would think that, actually, this could be a smooth transition. Lord Rose, indeed, said that there would be no abrupt changes.

Dr Carney: On all sides of this debate, there are strongly held views, lightly held views and those who are still making up their minds. It is incumbent on all of them to say what they think. We will only say what we think about the economy, as members of the MPC, with respect to the achievement of the inflation target.

Q104 **Mr Baker:** Dr Weale, you have generously conceded that the future is uncertain. I just want to, somewhat cheekily, put a few things to you. The Bank said that interest rates might well rise when unemployment fell below 7%. That did not happen. The Bank said they might rise when real wages started going up. That also did not happen. The Bank said interest rates might rise around the turn of 2016, which did not happen. If the Bank is unable to forecast its own actions, why should we take seriously these forecasts of consequences?

Dr Weale: Could I correct your first point? What the Bank said on unemployment falling to 7% was that it would not consider an interest rate increase until unemployment had fallen to 7%. That is not the same thing as saying that the interest rate could rise.

Q105 **Mr Baker:** What about the other points?

Dr Weale: On the other points, my sense is that people look to the Bank and to individual members of the committee—I have certainly done this—to give a sense of the way in which they see the economy developing. We have always said that these are indications and nothing more than that. I have said that these are the way I see things. I have certainly been surprised that wage growth has not picked up over the last year or so. I had thought that it would as the labour market tightened. The point is that, as I understand it, what this committee expects and what we are actually doing is describing things as we see them.

Q106 **Chair:** If I may just bring in Dr Broadbent on that point, you were indicating dissent.

Dr Broadbent: It was just a minor thing. It was not real wages; it is really nominal unit labour cost, which is something rather different. Real wage growth picked up a lot last year, thanks partly, if not mainly, to the big drop in commodity prices. We care more about growth of nominal unit labour costs, which has picked up, as have nominal wages,

but they have not picked up to levels that are consistent yet with meeting the inflation target.

Q107 Mr Baker: Since you mention commodity prices, why did the Bank not see the halving of the oil prices coming? It made a large difference to performance.

Dr Broadbent: Financial markets price in their best guess of what is going to happen over the future. That is another instance of where we take financial market expectations as given. We are not in the business of forecasting oil prices. Those who are in the business of forecasting oil prices and devote a lot of resources to doing so did not see it coming and no one does. That is in the very nature of an efficient financial market, as I am sure you know. I do not think that says anything about people's forecasting ability. If anything, the unpredictability of asset prices merely tells you about the efficiency of financial markets. It tells you nothing about the quality of forecasts.

Q108 Mr Baker: I think we are agreed that there is a degree of unpredictability in the events of the world. Your evidence has just demonstrated the categorical impossibility of forecasting major economic events.

Dr Broadbent: No, that is not true at all. What I just said was a point about the efficiency of financial markets, which had nothing to do with the quality of forecasts. That was the point I made. In terms of other things, let me make two points here. One is that the fact that forecasts are uncertain does not mean that they are useless. That is a false dichotomy.

Q109 Mr Baker: Why did the Bank fail to forecast a 30% fall?

Q110 Dr Broadbent: Hang on—

Q111 Mr Baker: No, I am asking the question; I am sorry. Why did the Bank fail to forecast a 30% fall in sterling against the dollar in 2008-09?

Chair: It would be very helpful if you could just complete the reply you were making.

Dr Broadbent: Just quickly on that point, I would make exactly the same point I made a moment ago about financial markets. Predicting asset prices is a wholly different thing. They are unpredictable by their nature, because of the efficiency of financial markets. That is the only point I would make there. We do not forecast those, nor should we. It is precisely because people make their best efforts to forecast these things that they become unforecastable.

Mr Baker: Can I just bring in Dr Vlieghe?

Dr Broadbent: Can I just finish this? There is a second point I was going to make. I was going to go on to say earlier that the fact that the future is uncertain does not mean that all forecasts are useless. That is a false dichotomy. There are directional things we get right. On average, if you look at year-ahead movements in GDP growth, most forecasters do not get those. They probably get less than half of those movements, but they go in the right direction. They are not useless. They are not perfect, but they are not useless.

One other point with respect to what we are talking about here, which may be some of the things connected with the referendum, is that this is rather different from a forecast. We are talking about changing one thing. There may be multiple things that follow from that one thing. In a forecast, we have to imagine lots of possible judgments going wrong. We are focusing only on one, so the degree of uncertainty, all else being equal, is slightly lower in that respect, if you are just looking at the marginal effect of changing something. The broader point I would make is that the fact that the future is uncertain does not mean that forecasts are useless.

Dr Vlieghe: I was going to echo strongly that last point, which is that what we are talking about here is not to say what will happen in some absolute sense. We are saying what will happen conditional on making a specific policy change, which is a very different type of forecast. You will also note that a lot of the language is cast in terms of not what will happen in an absolute sense, but how different it would be than if we had not followed that policy or if we had not changed policy. That is a completely different type of forecast from saying what the world would look like two years from now. We are saying how it would look different after all the policy change has been carried out.

Q112 Mr Baker: If I could ask you to look at charts 1.2 through to 1.6, which are at pages 2 to 4, the headlines on here are, “Market-based measures of risk premia have fallen back”, “International short-term interest rates are lower”, “Longer-term nominal interest rates remain lower than in mid-2015”, and “Real rates and implied inflation have fallen since mid-2015”. Would you concede that this does not show a marked change in these factors, as a result of the referendum being discussed at this time?

Dr Broadbent: I think that is right. Dr Vlieghe said a moment ago that we looked across a whole range of asset prices, using exactly the same sort of filter we apply to the exchange rate for referendum effects. We did not find systemic effect, for example, on the yield curve. That is why we made no adjustment for those things, so I think that is fair enough. It is pretty clear in some areas. It is pretty clear in which direction the foreign exchange market has gone. It is pretty clear in commercial real estate markets, for example, but you are right. That is why we did not make an adjustment.

Q113 Mr Baker: Let us just look at chart 1.6 then, because there are three measures on the chart. If we look at the dollar versus the pound, the divergence between that measure and the other two takes place back in 2014. Actually, since February, when discussion of the referendum has been most intense, that measure has been recovering. If you look at the bottom, chart 1.6, sterling has depreciated significantly. The point I am making is that the depreciation began and has been sustained since some time in 2014. Actually, since February, there has been a recovery, just at the time when discussion of these matters has been most intense. I am asking you to comment. Why is it that, at a time when uncertainty has been high because of the media reporting and the public statements, actually the pound has been recovering?

Dr Broadbent: Let me be clear. Between February and May, sterling fell significantly. Between our February and May inflation reports, it fell. The second point is, if you look

at the higher-frequency correlations, it is clear that there is a positive correlation between the market-assessed probability of remain and the value of the sterling exchange rate. That is clear. The same correlation exists to do with news in general about the referendum, particularly when it goes in that direction. We have done the work on this. As I have said, you are absolutely right that the evidence is not there in fixed income markets. That is why we made no adjustment for the purposes of the forecast, but it definitely is there in the foreign exchange market. That includes, as Martin said, the period of the last two or three weeks.

Dr Weale: If you look at chart A on page 5, that shows what has happened since November. You can see there that, as we know, there has been a significant reversal of the decline since April. The sense I have is that that is as the remain campaign seems to have been gaining strength, at least as indicated by averages of polls.

Q114 **Mr Baker:** Finally, Governor, you heard what I said at the beginning of my remarks. In the same spirit of good will, can I ask you to dismiss something that I feel sure will be brought up? That is that we know that Goldman Sachs has been a donor to the remain campaign. You are a former managing director of Goldman Sachs. Could I just give you the opportunity to refute any suggestion that Goldman Sachs may have put pressure on you to say to take a view?

Dr Carney: Wow.

Mr Baker: It is not an allegation; it is an opportunity to refute it.

Dr Carney: Yes, I refute it categorically and am stunned to even have it raised.

Q115 **Stephen Hammond:** Good morning, gentlemen. Dr Vlieghe, could I take you back to your speech of 8 March about unconventional monetary policy? There are three things about that speech I would just like to ask you about. You were talking about the impact of negative interest rates and that there was a risk of adverse side effects. I was not clear from rereading the speech again whether those adverse side effects were a comment on the efficacy not working at all or whether there were other things you had in mind.

Dr Weale: What I had in mind was that, in some countries, for example Switzerland, where negative interest rates have been introduced, that on its own would have had the effect of worsening bank cash flow. Mortgage rates in Switzerland have gone up. When the MPC has reviewed the issue of negative interest rates, as for example we did in early 2013—Charlie Bean wrote a report to this Committee, as far as I remember—we very much drew attention to the possibility that there could be perverse effects.

Indeed thinking further back, before I joined the committee, the reason that it saw 0.5 percentage points as a floor for the Bank Rate, at that stage, was that it thought that the conditions of the banking system then were such that any further reduction would be likely to tighten credit rather than ease credit. Now, more recently we have looked at things and thought that there is room for some further decline, should the committee think it necessary. Going back to my own views, this is in some sense borne out by the way the general discussion has changed since January. There are risks that they would have

impacts on the banking system which, far from easing monetary conditions, could serve to tighten them.

Q116 Stephen Hammond: Your current judgment on the balance of risk is that the side effects would not be adverse.

Dr Weale: My current judgment is that the side effects might well mean that you probably would get a more depreciated exchange rate, but of course everyone cannot depreciate against everyone else. Normally easing monetary policy leads to domestic easing as well. There is a very real question in mind about whether that would actually happen.

Q117 Stephen Hammond: In another part of the speech, you talk about how impressed you were against your initial scepticism about the efficacy of quantitative easing and asset purchases, in the first, second and third rounds. There is also a comment about negative interest rates now. As you prepare to leave the MPC, are you confident that its QE and Bank Rate are the major tools that your successor needs to concentrate on in looking at stimulation of the economy?

Dr Weale: No, that would be up to my successors, if and when they think the economy needs any stimulus. If I were staying on the committee, I would be looking at those two tools as means of providing stimulus, if I thought it were needed.

Q118 Stephen Hammond: Are those the only two tools you see or do you think there needs to be closer co-ordination between monetary and fiscal policy?

Dr Weale: I certainly would not want to rule out other forms of policy being identified, for instance the Funding for Lending Scheme. It was exactly the right policy at the time. I supported it. In broad monetary terms, were I still to be on the committee sometime in the future, those were the things that I would be imagining myself using, if I were looking ahead now.

Q119 Stephen Hammond: In a similar line, can we turn to your Shanghai speech? Again, you explicitly state the view that the “ammo”, which is quoted from monetary policy, has been used up is wrong. In the same speech, you run through the fact that rates cannot be brought forward; the wealth effect is limited, as you see successive rounds of quantitative easing; and negative interest rates are relatively poor at boosting demand. What gives you confidence that you have enough “ammo” left for monetary policy?

Dr Carney: May I just preface this? We are obviously speaking entirely in the hypothetical, so I am not sending any signal about the path of monetary policy.

Stephen Hammond: You have made that point clear.

Dr Carney: Thank you. As Dr Weale referenced, we have done more work. It is not that we have done more work, actually. The building societies particularly of this country have built capital over time and built resilience. As a consequence of that, the lower

bound that was 0.5% when Dr Weale joined the committee we now think is much closer to zero. We have updated our thinking on that and, in large part, we have benefited from the structure of the Bank of England, because we are also the supervisor of these entities. This is a fairly refined judgment. We are not just guessing at the profitability and the impact on the transmission mechanism, so we have conventional space.

I agree with Dr Weale and others that we could engage in quantitative easing, if that were necessary. We could look at some form of credit easing, whether it was a variant of Funding for Lending or some sort of purchase of credit assets. What is crucial in the last case is that we are not making any credit allocation decision ourselves. The decision of the programme would have to be made in a way so that either the banks themselves were making those judgments about where the credit is flowing, taking existing assets off balance sheets for example. My point is that there is a range of alternatives and combinations of those alternatives that exist, well before one gets to negative interest rates or some other more extreme variant of monetary policy.

If I can come back to the Shanghai speech that you referenced, at least personally, and colleagues would have slightly different frameworks but similar ways of looking at it, I think, it is important that we look at how a monetary policy instrument affects the various channels of monetary policy. If you are undermining the confidence channel or if you have a perverse effect, as we have seen in some jurisdictions, where credit interest rates are actually going up in mortgages or others, because of the ways the banks have to manage their profitability, obviously that is counterproductive and other alternatives should be tried.

Q120 Stephen Hammond: Continuing with the speech, you also say “demands that our firepower be well aimed”. I take it from your last answer to my question that you think that credit easing would be less well aimed than QE.

Dr Carney: The point in that sentence was similar to Dr Weale’s point a moment ago, which is that everyone cannot depreciate against everyone else. The start of that speech references a risk—it is a risk and it is a tail risk—of a global liquidity trap, at a time when there was some risk of monetary policy being too focused externally in too many jurisdictions. It is trying to bring things back to well-aimed domestic focus, boosting domestic demand through these other channels. All monetary policy has an exchange rate impact, but it should not be the focus of monetary policy. That has been consistent with the discussions of G7 and G20 central banks in recent months.

Q121 Stephen Hammond: Can I just touch on one of your other speeches, again talking about “well aimed”? One of the other monetary policy aspects that has been in discussion is the phrase “helicopter money”. As you know, there have been some articles about it. You have dismissed it, I think, as a “compounding Ponzi scheme”, in a speech in April. Economically, you think this is an unsuitable method of directly putting easing into the economy and you think the economic consequences of that are inappropriate in the current circumstances.

Dr Carney: They are certainly inappropriate in the current circumstances, in the design. This is extreme policy and it is a fusion of monetary policy and fiscal policy. It requires a

credible commitment, in effect not to recapitalise the central bank, because ultimately the central bank is purchasing assets that will never be redeemed, never be paid back, effectively zero-coupon perpetual notes. The central bank would be financing that by putting reserves into the banking system. At some point when monetary policy normalises and interest rates have to increase, the central bank has an obligation to pay interest on those reserves. It does not have an asset that pays interest and so it has to get the money from somewhere else. The danger is it gets the money by issuing more reserves to pay interest on the reserves. That is the compounding Ponzi scheme aspect of that. One of the challenges is that, in order to get around that issue, some thought is given to potentially taxing the banking system, in order to recoup the money to repay the banking system. There is a circularity there and a transmission issue as well.

All that said, Lord Turner, Ben Bernanke and others are thinking about the political economy of this in extremis. I respect their work, but it is certainly nothing that is of any interest in the current circumstance and it has fundamental problems. One of the fundamental problems is a political economy problem, because the independence of the central bank goes away at this point where you have to fuse, in terms of co-ordination with the Government, the fiscal authority.

Q122 Stephen Hammond: Finally to you, Dr Broadbent and Dr Vlieghe, can I just be clear that both of you are of the view that we can be fairly confident in relying on quantitative easing as the major tool of monetary policy, rather than anything else, in the current circumstances?

Dr Broadbent: Were it necessary, yes. There may be some evidence that its potency was at its peak the very first time it was tried. That would be understandable, given the dysfunctionality of markets and the fact that no one really expected it until it happened, but I would expect it to have some impact. As the Governor said, there may be a variety of options.

Q123 Stephen Hammond: At the margin, its impact is less effective every time we do it. Is that what you are saying?

Dr Broadbent: It is not necessarily every time. I do not think it is a deduction that it necessarily falls over time. There were particular reasons why it was most potent when it was first done, but I do not think that means that there is some inexorable fall in its marginal impact, nor do I think that that marginal impact is zero. There may be other things that you want to do, depending on the circumstances, as with the FLS, for example.

Dr Vlieghe: I agree with the point. I am optimistic that QE, should we need it, would still have the desired effect. It might be smaller than the first time we used it, but that does not mean that it is not a useful tool anymore. I would also emphasise, as the Governor has also said, that we still have some room on Bank Rate.

Chair: The unwinding of QE will be a long-term preoccupation of this Committee and these exchanges, I am sure.

Q124 Chris Philp: Good morning, gentlemen. I would like to start, if I may, by asking about the current account deficit, which is discussed on page 18 of your May report. Governor, your report notes that the Q4 2015 current account deficit stood at 7% of GDP, which is the highest it has been since records began in 1955. It is a question I have raised with you on previous visits, you probably recall, and I wondered if you could comment on whether you are concerned that the figure is now even higher than it was when we previously discussed it.

Dr Carney: It is safe to say that our concern about the current account deficit has not gone down. There are two sets of concern. I know you are meeting with some of our colleagues on the Financial Policy Committee, this afternoon. They can, if asked, provide their perspective on it. Let me say that, from a monetary policy perspective, there are two sets of issues here. One abstracting from the referendum is that one of the drivers, in fact the principal driver, of the deterioration of the current account, as you know from our previous discussions, has been the primary income balance. We are earning less from abroad than previously, in effect; a very large stock of UK investment is abroad. At some point, there will be a reckoning with respect to the primary income balance. The reckoning can take several forms. One can be that that lower return from abroad can right itself; those returns can go up. Secondly, it can be that the exchange rate moves in a way that helps balance this out, so what we are sending abroad is worth less in foreign currency.

Q125 Chris Philp: Do you mean a depreciation of the currency?

Dr Carney: Yes, a depreciation of the currency, and what is coming in is worth more. The third is something that could slow the economy, which is that companies and individuals, who ultimately own these assets, decide that their future streams of income are going to be lower than they had thought. Therefore, savings out of current income go up and that contributes to a slowing of the economy. There is a set of issues around that that bear watching.

There is an issue related to the principal topic we have been discussing this morning, which relates to the referendum and the funding of that current account deficit. It moves around, year to year, but in general it can be characterised as a heavy proportion of that being foreign direct investment. There is the possibility that, for a period of time at least, the UK is less attractive. That does not mean that it is not an attractive destination for foreign direct investment, but it is less attractive, to simplify it, because of uncertainty about future relationships. That, plus a potential risk premium on UK assets, means it is more expensive to fund and less of the current account deficit can be funded. Therefore, it shrinks or there is less investment. That is another way of putting it. There are more domestic savings. That is consistent with a material slowing in the economy, so the current account adjustment could reinforce other factors that cause the slowing.

Q126 Chris Philp: Just to make sure I can summarise what you have said, the historically large current account deficit has largely been financed by foreign direct investment. You are saying that you would anticipate, in the event of Brexit, that

foreign direct investment is likely to diminish. In fact, there are some signs of that already. I am correctly summarising your position?

Dr Carney: The point is about the relative flow. Even this morning you may have seen a report from one of the consultancies, EY, I believe, which shows what we kind of know: for roughly three quarters of foreign investors, at least in this survey, membership of the EU has some importance—I will put it that way—to their investment decision. While the terms of that relationship are being renegotiated, one would expect less. That is reasonable; one sees signs of it already. The investment becomes more expensive.

Q127 Chris Philp: In fact, the European head of KKR has said publicly that they have already suspended their investment programme in the UK, pending the outcome of the referendum. Were there to be a material decline in FDI, at least for a year or two post-Brexit, as you are suggesting, bearing in mind the current account deficit that we have just talked about, what impact would it have on sterling over a three-to-six-month horizon.

Dr Carney: It is hard. This is all related, of course. Probably the best way to answer that, if I may, is to go back to the broader forces.

Chris Philp: That was a semi-rhetorical question.

Dr Carney: Yes, but to go back to the broader forces, the combination of a hit to supply for some period of time and a reduction in demand would be consistent with a depreciation of sterling, in order to rebalance the economy. I will put it this way: it is likely that the non-tradeable sector of this economy—the domestic sector—will have to increase relative to the externally focused sector of this economy, for a period of time. We are not making judgments about the longer term, but for a period of time, because of changing trading relationships. That would be reflected in the current account.

Q128 Chair: You are saying that it is because of some loss of access to EU markets. That is what you are saying. It is not a change, but a reduction.

Dr Carney: Yes, a reduction. I was being polite.

Chris Philp: In the event of—maybe ‘sterling crisis’ overstates it.

Dr Carney: It does overstate it, to be clear. If I may, Mr Philp, a necessary adjustment in the exchange rate, which could be large and certainly material, is entirely different from disorderly balance creating sterling crisis.

Q129 Chris Philp: Let us say that there was a significant reduction in the value of sterling. Would you see that as an event that would require intervention by the Bank, would you only intervene if it had an inflationary implication or would you simply see it as the orderly evolution of the market in response to circumstances and let it play out as it plays out?

Dr Carney: It is an important question and it is important to be clear about this. The United Kingdom, to its great credit, has been committed to free floating of the currency. You would not expect the Bank to stand in the way of necessary adjustment in the

exchange rate. It would be inconsistent as well to use the exchange rate for competitive purposes or other reasons. That would be inconsistent with our G7 commitments. We as an institution will take all necessary steps to ensure that markets are orderly. The principal steps that we expect to take in that regard we have already announced, which are the liquidity facilities that we discussed last time we were here.

Q130 Chris Philp: Just winding back to the point you made earlier about the contribution of the primary income account to the overall current account deficit, you are quite right that it is the most significant contributor to the marked decline. In 2011 and previously, it was contributing +2% of GDP to the current account deficit, i.e. it was actually helping it. It is now contributing, roughly speaking, -3%, so that is a relative move of -5% of GDP between 2011 and 2014. Part of that, as you said, is due to a decline in returns on overseas holdings.

It has also been suggested, not least by Philip Lane, who is now your counterpart in Ireland, that it has also been caused by a deterioration in our net international investment position. Between 2011 and 2014 that went from -5% of GDP to -25% of GDP. I also handed you a paper a few months ago published by Philip Lane. I do not know if you have had a chance to read it. I wondered if you shared the view that it is not simply down to a reduction in our overseas earnings, but is also due to the fact that our net international investment position appears to have deteriorated. I know the figures are subject to revision at the moment.

Dr Carney: They are always subject to revision. There are several elements in there. First, I did read the paper you handed me. I wrote to the Committee. I believe the letter was ultimately published, a few months ago, in a flurry of various things being published. Governor Lane has made a number of interesting observations in this area, not just about the UK. The paper to which you were referring, I believe, had a greater emphasis on tax-shifting and that being a potential consequence. At least in our analysis, we think this could be a minor element, as opposed to a major element of that. That is the first point. Secondly, in terms of the shift in the overall value of our net international investments—we are talking about the stock now, as opposed to the flow—

Dr Broadbent: There are a couple of points that I was going to make. One is that that is not the picture you get if you try to measure it at market prices as opposed to historic cost, which is the basis on which the national account is measured. Now, my neighbour will tell me that even the basis of the weights one uses is ancient in its origin, so all these figures are a bit unreliable. Since in particular equity prices have gone up around the world, over the last couple of years, the position will not have deteriorated when you measure it at market prices.

The second point I would make is if you think about orders of magnitude, the size of the gross stocks and the average return—

Chris Philp: It is around £10 trillion on either side.

Dr Broadbent: It is at least five times your GDP. A decline of this order of magnitude, at given rates of return, would explain only a very small portion of the decline in the income balance you have been talking about. The vast majority of this decline is represented not by a change in the stock but a fall in the net rate of return on it.

Q131 Chris Philp: It is the relative levels of the stock, the net position.

Dr Broadbent: Yes, the fall in the net rate of return on those assets has been the more material thing. For many years, the rate of return on our assets, on average, exceeded that on our liabilities. Now the opposite is true. My guess would be that it would improve slightly, albeit not back to a healthy position.

My final point is on the very long-term view. You are right that, long term, one can be slightly more confident of the numbers, but we had a very big surplus on the net stock some decades ago and that has been eaten away. Whether or not it has deteriorated as much as you say in the last four or five years, I would be more doubtful.

Q132 Chris Philp: The ONS said in February that they are about to revise their figures. The 2015 figure actually has a much lower net investment position deficit. It seems to have contracted remarkably, but I think there are some issues with the underlying statistics.

Dr Broadbent: There often are.

Dr Carney: I would just make a minor point, if I may. There is some detail in terms of the extractives sector. It is a little more pronounced in the very near term, in terms of flows.

Q133 Chris Philp: Just moving on from the current account deficit, which I am sure we will discuss again in the future, you mention on page 13 of the inflation report, at the bottom of column 2, that you are keen to make sure that banks and lending organisations “maintain and do not loosen underwriting standards”, you say. You also mentioned earlier that you will be very diplomatically concentrating on FinTech and alternative lenders in your Mansion House speech to avoid the political pitfalls that some of my colleagues have referred to earlier, although I personally think that you are perfectly entitled to comment on events like Brexit and would encourage you to carry on doing so.

On the question of FinTech and alternative lending, we have seen a lot of very negative news flow from the US recently. Organisations like Lending Club have lost their CEO. It is the US’s largest peer-to-peer lender. It was because they securitised a lot of loans and it turned out that they were much worse quality than they had represented. You have an unregulated sector here, taking money from individuals and lending it, taking no balance sheet risk themselves. Is this not just a classic rerun of the problem we had in the run-up to the financial crisis, when organisations wrote loans with no intention of holding them on their own balance sheet, with no skin in the game, and passed them off to third parties? In that case it was through mortgage securitisations; in this case it is passing them off to individual people, who usually have no financial expertise. Given the news flow from the US, given the experience of the run-up to 2007, would you not agree that while there is a lot to be said for FinTech and it is good that London is the centre for it, it is posing financial risks and the companies doing this are not appropriately sharing the risks that they are passing off to their investors?

Dr Carney: Mr Philp, you are raising important issues.

Chair: Part of which have a bearing on the financial stability committee as well.

Dr Carney: Yes, that is true, and I was going to say these are financial stability issues.

Chris Philp: That is why I am asking you.

Dr Carney: Exactly, and I will answer in that context. Let me say a couple of things. First, it is important that the balance on regulation in these emerging industries is correct. In other words, speaking from the perspective of the FPC or, ultimately, the PRA, which has the secondary competition objective, some allowance for an appropriate degree of regulation, early-stage, to encourage development in various alternative lenders may make sense, but those have to be very considered judgments and they cannot be judgements for the totality of time. That is the first point.

Secondly—and I should not speak specifically about the one firm in the US but will make a general point around some of the issues that have been raised there—is it truly a peer-to-peer lender? In other words, is it effectively a marketplace for a saver and a borrower, or is the institution warehousing the loan, so acting a bit as a bank—

Chris Philp: And providing liquidity management.

Dr Carney: And providing liquidity management, which then shifts into banking-like activity. That is where we become much more interested, because then somebody is acting as a quasi-bank and not representing. If one can take a bit of comfort from what happened in the US, as I understand it, it is that, regarding the potential underwriter or purchaser of some of the securitised assets, the reason the assets were not purchased or ultimately the deal fell apart was because they did not meet the underwriting standards. Unlike pre-2007 or 2008, where everything was waved through, standards were maintained.

There are examples of peer-to-peer lending here in the UK that are true peer-to-peer and are not becoming quasi-banks. We need the right regulatory framework for that. That will be not the core of what I am talking about, because I am going to talk more about enabling technologies, issues around central bank digital currency—things that are closer to Mr Baker's heart.

Q134 **Chris Philp:** Would you agree that it would help eliminate the moral hazard inherent in this if the people originating these loans retained, say, a 10% first loss piece? That would concentrate their minds when they were underwriting and originating these loans in the first place.

Chair: That is a question for the financial regulators.

Chris Philp: I was not asking you, Chairman. I was asking the Governor.

Chair: I am going to limit the scope of the Governor's reply, because he is not directly responsible for it.

Dr Carney: The short answer is yes, it would align incentives, absolutely. There is some interest in it, but there is merit in preserving the existing business model, which is literally a marketplace model, truly peer-to-peer, and so I would not want to have a prescription that that was required, at least given our knowledge base at this stage.

Chair: It is a very interesting area, which this Committee is going to do some work on, FinTech, over the next year or two, if we get the chance.

Q135 George Kerevan: Good afternoon, gentlemen. I want to park the referendum and talk about inflation. It seems to me the labour market is quite tight yet there are signs of deceleration in wage growth, which seems counterintuitive. Could you elaborate more on the Bank's thinking about the state of the labour market and its impact on inflation over the next period?

Dr Broadbent: I do not think there are signs of deceleration in wages; the rate of wage growth is weaker than we had expected a year ago. These things bump around from month to month, but wage growth over the last year was materially higher than it had been, on average, over the previous five. The same goes for growth of unit labour costs. Nevertheless, those growth rates are both lower than we expected a year ago, which is definitely true, and lower than we judged to be necessary, if they were to prevail, with meeting the inflation target. Those points are true, but I do not think it is decelerating.

Q136 George Kerevan: Okay, we will leave that. My point is that, clearly, given the strength in the labour market and labour market participation, it seems that that is not feeding through into inflation in the way that it would normally have done historically.

Dr Broadbent: Not as much as we would expect.

Q137 George Kerevan: Why do you think that is? Will that change? How are you taking that into account in terms of future inflation forecasts?

Dr Broadbent: One has to adjust for the degree of productivity growth, first of all, which has been lower; even though that has picked up too, slightly, it is still well below its pre-crisis average rate. That will affect the benchmark figure one has in mind for wage growth for any given rate of unemployment.

Secondly, as the Committee said in the February inflation report, it is quite possible that the period of very low inflation—close to zero inflation—that we have had may, for a time, depress growth of nominal earnings. Certainly it was true that when you had the big headlines about zero-rate inflation and the possibility of deflation a year or so ago, it was followed in the spring and summer by pretty stagnant nominal wages and in the last six months you have seen some re-acceleration. We cannot diagnose it precisely. As usual, we have more potential explanations than we do bits of data, but the Committee's belief is that the period of low inflation may have had something to do with it.

Q138 George Kerevan: That is interesting. That is really a causal effect: low inflation is impacting on the labour market.

Dr Broadbent: You can see the short-term impact. You are right there is feedback, potentially, both ways; that is true. Of course, our expectation is that inflation rates will climb through the course of this year, not at an enormous rate—we are going to get to around one at the end of this year—but they will climb.

Q139 George Kerevan: I remain slightly sceptical about the degree to which we will see inflation picking up compared to what you are putting in the report. One of the elements I am trying to identify is that it seems to me that the labour market is not producing the same kind of normal impact on wage growth that would feed into inflation that we have seen in historical periods. I am pressing you gently, because you seem to be finding exceptions to prove the rule that ultimately it will pick up, whereas what we have had for several years now is that even though it has improved significantly since the recession, the labour market has not yet managed to click on to any degree of inflationary impact.

Dr Broadbent: I do not think that is entirely right. There are exceptions. There has been a noticeable impact of a tighter labour market on wage growth. As I say, we have seen faster wage growth over the past year than for a number of years, certainly in the private sector. That reflects the tightening of the labour market, but there have been other things going on. It would be odd, for a relationship that has over the last 20, 25 or 30 years fitted the data quite well, to say, after a noticeable period, within the last three or four years, that it has not worked and therefore we need to throw the whole thing out. That would be the wrong conclusion to draw. I do not know if anyone else wants to comment on that.

Dr Weale: Obviously, we have considered different explanations of why growth in wages might be weak. One is that the labour market has changed, so that, whereas at least Bank work suggested that you needed an unemployment rate of around 5% in order to have wage growth consistent with the inflation target, it is possible that that has come down now, although detailed work on the workings of the labour market does not suggest that. Another explanation, as Dr Broadbent said, is that we have had a period of very low inflation. If you look at growth in real wages, which is on page 22 of the inflation report, you can see that real wage growth has been close to its average rate. You made the point about wage growth depending on inflation; if you think back quite a long time now, fortunately, to when we used to have high inflation rates, we used to get wages and prices growing by 10% a year or more and then wage growth was reflecting inflation as well as being a driver of inflation. There is certainly a feedback there and time will tell. My own view is that the pickup in the inflation rate is going to come and will be forecast coming. As the effect of oil price declines and other similar factors drop out of the system, I would expect to see wages also pick up.

Q140 George Kerevan: Leaving out the referendum as far as we can, you mentioned earlier that there was some deceleration and loss of momentum in the economy at the beginning and middle of last year. What is your medium-term prognosis about economic growth? What kind of data have you received, for instance, from the agents about regional growth versus the national trend?

Dr Carney: Certainly it is right that we have seen, as Dr Vlieghe said, from the sharp acceleration in early 2013, a period of about 3% growth then shifting down to 2.5% or so annualised, the high twos in the middle of last year, down to around 2% at the turn, then further deceleration: 1.5% in the first quarter and now we think around 1% is what our forecast is for the second quarter, maybe lower than that. Stripping out the referendum effect, as you suggest, as we get to the latter stages of what is happening with that declaration, the bigger picture would be a movement towards growing broadly consistent

with the rate of supply growth in the economy, which is lower than it previously was. Probably the best way to look at that is when we get out to years two and three of our report, so the uncertainty effects have dissipated in terms of our forecast and the economy is broadly growing in line with supply; it actually grows a little above it. We have the economy growing around 2.25% on an annualised basis, so it is arguably growing just a bit faster than supply growth in the economy.

I will flag one thing, if I may, and the Chair raised this. In the first quarter, which was a relatively weak quarter, there was a pretty sharp increase in residential real estate transactions related to the tax changes that came in. Of course, what one would expect, and we pick it up in our nowcasting data, is that there is a payback for that, irrespective of the referendum that is going on in this quarter and maybe into a bit of the third quarter; people brought forward purchases to avoid stamp duty. It is a rational thing to have done, but it has a bit of an impact. We have to try to strip out that aspect to see the underlying, but my bigger-picture point would be the economy is coming back to growing, in our view, in line with supply, which is a little more than 2% per annum.

Q141 George Kerevan: Is there any regional difference?

Dr Carney: There are always regional differences, but, as you know, we do not forecast by region. I would say the recovery is fairly broad-based and it would appear that the slowing is fairly broad-based regionally as well. The recovery has been broad-based, but the slowing has been as well, and the question is how temporary that will be.

Q142 Chair: Martin Weale, you are leaving in August, just after the next inflation report, and so it is possible that you may not come before us again in your current capacity. I just wanted to take this opportunity to say how grateful we are to you for the long period of service you have put in. You have certainly always shown a great deal of independence of mind; that cannot be in doubt and you have always expressed your views extremely clearly to us all. We are very grateful for your period of public service and we hope it is not the last.

Dr Weale: Thank you very much, Chairman.

Q143 Chair: I have the *FT* here, Governor. I do not know whether you have read this today over your breakfast porridge or whatever you have in the morning when you are not having breakfast with the Chancellor. It says that in British Government circles, “there is an unofficial pantheon” of foreigners considered “best placed to shape public opinion”, and that Mark Carney “appears to carry most clout”. A recent poll deemed your views to be more important than those of the Queen, Angela Merkel and doubly as important as those of the President of the United States, which does seem to put you in a pretty unique category. I am sure you understand that it is in that context we have been examining the extent to which you have decided to express a view on Brexit and the importance of making sure that we understand these rules and stick to them.

Dr Carney: Thank you, Chair. I take it you will not be calling the other people on that list.

Chair: She is not on the list, but I would not underestimate the possibility of Christine Lagarde drifting by when she comes in a few weeks' time, if she does decide to put both feet in it.

Dr Carney: I do not know, but I would join you in your praise of Dr Weale, who has been an excellent colleague and I will associate myself entirely with Dr Broadbent's comment earlier. We did not decide to intervene—you did not use that word—but we had to talk about these issues in fulfilment of our remit, as you appreciate.

Chair: Every inflation report is an intervention and we look forward to the next one. Thank you very much for coming and giving evidence to us this afternoon.