

Treasury Committee

Oral evidence: Appointment of Michael Saunders to the Monetary Policy Committee, HC 729

Tuesday 11 October 2016

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Watch the meeting

Members present: Mr Andrew Tyrie (Chair), Stephen Hammond, George Kerevan, Chris Philp, Mr Jacob Rees-Mogg and Rachel Reeves

Questions 1 - 32

Witness

I: Michael Saunders

Examination of witness

Michael Saunders

Q1 **Chair:** Thank you very much for coming to see us today, Mr Saunders. Can I begin by asking you whether you think the Bank of England's independence is in any way at risk of becoming compromised, as the distinction between fiscal and monetary policy becomes blurred with the measures required to address it?

Michael Saunders: The Bank of England has enormous responsibilities: monetary policy, macroprudential policy and banking supervision. I would hesitate long and hard before seeking to have any say or control over fiscal policy as well. Fiscal policy in this country has always been set by the Government with democratic control, and that is not something that I am seeking to change. The Bank of England's independence in turn is underpinned by Parliament, and that is a decision for you, but I am certainly not seeking to challenge it.

Q2 **Chair:** Is there not an element of fiscal policy in QE?

Michael Saunders: No, I do not think so. It is unconventional but monetary policy. All monetary policy actions have some fiscal effects. That is fairly normal; when you cut rates or hike rates, there may well be effects on the fiscal position. I do not think that QE in that sense is so very different to bank rate.



Chair: When you change bank rate, you do not require an indemnity against PSFD.

Michael Saunders: That is true. The Bank of England, because it is taking assets on to its own balance sheet through the APF, needs to have an indemnity against that. As to the fiscal effects of that on the Government as a whole, obviously there may be gains or losses on the gilts. Those may be offset in part by swings in debt service payments that the Government get as a side effect of QE, but we are certainly not seeking to set fiscal policy.

Q3 **Chair:** When the Prime Minister said people with assets have got richer while people without have not, she was referring directly to QE here: "A change has got to come, and we are going to deliver it because that's what a Conservative Government can do." Do you think that has any implications at all for the independence of the MPC?

Michael Saunders: Monetary policy has distributional effects. All monetary policy actions do. When you cut interest rates, borrowers gain or people with future borrowing needs are better off because their debt service payments are lower. The same would apply to asset holders as asset prices rise. QE also pushes down on long rates and pushes up on asset prices. Its direct effects are going to benefit some groups more than others. I should add, though, that its indirect effects in terms of boosting growth and employment are very widely felt.

I do not think that we, the Bank of England, can solve the direct distributional effects of monetary policy. I do think that you, Parliament, and the Government have many more tools for that. We cannot set different interest rates for different groups. If we were to keep interest rates higher in order to, in the short run, make life easier for people on savings income or to make the position of defined benefit pension schemes easier, then the economy would be weaker, unemployment would be higher, asset prices over time would be weaker and eventually, I suspect, interest rates would be even lower as a side effect of a depressed economy. I do not think that would work, even with the narrow aim of helping people's interest income.

Q4 **Chair:** To clarify, it is therefore your view that QE should be set and administered blind to the distributional effects.

Michael Saunders: I care a lot as to whether the distributional consequences of monetary policy are reducing its effectiveness. It is conceivable, in theory, that you could reach a tipping point at which the potential adverse effects of QE, for example on the deficits of DB pension schemes, might cancel out more than offset the positive effects of higher asset prices and lower rates as a boost to growth. Obviously, if that was the case, then the value of QE as a tool for stimulus would be much less. I do not think we have reached that tipping point yet, but I should add that this is something we are trying to monitor very closely.



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Q5 Chair: Perhaps I will go back to my question. From not that answer but the earlier answer, am I right to conclude that in your view the Bank should set its QE and its monetary policy blind to the distributional effects on the grounds that those distributional effects are a matter for Parliament and the Government?

Michael Saunders: Unless those distributional effects reduce the effectiveness of our monetary policy tools. If that were to happen, then the distributional effects—

Q6 Chair: There is just one word missing from that, which is “yes, unless”. Is that correct?

Michael Saunders: Yes.

Chair: Now I have understood, thank you.

Q7 Mr Rees-Mogg: Mr Saunders, welcome to the Treasury Select Committee. I was going to ask a bit more on monetary policy and fiscal policy because, since 2010, there has been a relatively tight fiscal stance and a loose monetary one. If the fiscal stance is going to become easier, does that have implications for monetary policy?

Michael Saunders: Yes, of course. In making that judgment, you would have to distinguish a bit between any changes in the fiscal deficit outlook that come about as a result of automatic stabilisers and then any discretionary fiscal measures, and also whether there are any knock-on effects on asset prices. In trying to achieve our inflation target, we take fiscal policy as given. If fiscal policy were to change, then that might have implications for the economy, which we would try to take into account.

Q8 Mr Rees-Mogg: It has had obvious consequences for confidence of the market in gilts issuance, in that the attempt to balance the budget has been something that broadly markets have liked and therefore has kept long-term interest rates down. Is that fair or do you think that the stability implications of a tight fiscal policy are overdone?

Michael Saunders: There has been a whole stack of factors, not unique to the UK, that have been pushing down on long-term rates. It is a global trend. Some of it is due to demographics or debt, and perhaps the rise in savings by emerging markets. The price of investment is less, and so firms invest less to get the same quantity of capital goods. Public investment has been weaker globally. Some of these are UK factors, but I suspect that UK yields would be relatively low even if fiscal policy had been less tight in the last few years.

Q9 Mr Rees-Mogg: Somewhat like Japan, which was in large deficit, very large debt, and yet interest rates have remained very low for 20 years.

Michael Saunders: Yes. In their case, it is much more a case of persistent deflation or low inflation. We have had a couple of years of low inflation in the UK but on nothing like the Japanese scale.



Q10 Mr Rees-Mogg: As it is currently set, and with the announcements the Government have been making around fiscal policy, are you confident that the current monetary policy can broadly continue or is it too early to say?

Michael Saunders: I think we are still able to achieve our remit. It is fair to say that monetary policy is burdened; I do not think I would yet say it is overburdened. If we reach the point at which we lack the monetary policy tools to achieve our remit, then, to me, that is what would qualify as being overburdened and I would say so.

Q11 Rachel Reeves: Thank you very much for coming to the Committee this morning, Mr Saunders. I want to ask you a little bit about the position of sterling and the recent volatility that we have seen. First of all, obviously there has been a fall, but there has also been a high level of volatility, with the 6% fall overnight on Thursday. Do you think volatility in and of itself should be a concern? Is it a concern to policymakers?

Michael Saunders: For short-term volatility, I do not think so. The largest part of the drop in the pound is an adjustment to the prospects of EU exit. We do not know yet what the exact shape of the UK's arrangements post-Brexit is going to be, but the work done by the OECD and the IMF suggests that UK potential growth will be lower in the long run as a result of Brexit. The factors behind that probably also argue for a lower equilibrium exchange rate. That adjustment is the main thing that is pushing sterling down.

Now, if the speed with which the currency fell were to create ripples and big side effects on other asset markets, then that might be a cause for concern. However, if all that is happening is that we are adjusting quickly to a new equilibrium, then to me that is not a cause for concern. The speed of adjustment is not a problem. Having said that, I do not want to give the impression that there is any particular level of the exchange rate that we have defined as the correct one or we are seeking to defend. The Bank of England has long ago learnt its lesson on that.

Q12 Rachel Reeves: The IMF said in 2015 that sterling was one of the most overvalued currencies and overvalued by up to 20%. That was before we voted to leave the European Union. How certain are you that the falls in sterling that we have seen are to do with leaving the EU? Was this an adjustment that was going to happen anyway?

Michael Saunders: I think that is fair. The drop in the pound is not solely due to the vote for Brexit. The UK has had, for a number of years, a very large current account deficit. Had the pound stayed at the highs that we had last year, then the UK would have been stuck with very low inflation, perhaps even negative inflation, because of the downward pressure from import prices.

Equally, you cannot separate the drop in the pound from Brexit. You can see that the large part of the drop in the pound occurred on the day after the vote for Brexit, and you can see how subsequent movements in the



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exchange rate have also come alongside timings of Brexit. That is playing a major role.

- Q13 **Rachel Reeves:** In terms of the link between the exchange rate and the real economy, you have touched on both of those issues in terms of the current account and the competitive position of our exports, and also on inflation. What would you expect to see in terms of our export position, current account position and, indeed, inflation as a result of a fall in sterling of 15%?

Michael Saunders: You have to start with the decision to leave the EU. That probably is a modest negative for UK potential growth over the long run. Part of that comes because of the possibility of reduced trade openness—it might be harder to do trade deals that fully replicate the way we were, although I acknowledge it is still early days on that—reduced inward investment and reduced inward migration. The UK might find it harder to specialise to the same extent in some high-value-added industries that previously did quite well in the UK because of the single market.

If you did not have a drop in the pound, then the effect of all of that would probably have been a markedly weaker export performance. The drop in the pound may well offset that. It is too early to say as to whether it will more than offset it, given that we do not yet know the nature of the UK's post-Brexit arrangements. Broadly, I think we will see in the next few years that the current account deficit will shrink a bit, and I suspect that might be more because of slower import growth, as well as better exports. Inflation is likely to rise from close to zero recently, certainly back to 2% next year and probably above the 2% target in the next two to three years.

- Q14 **Rachel Reeves:** Picking up on two of those points, you said that the improvement in the current account position might be more likely to come through a lower level of imports. Is that because of the change in the value of sterling or is it because of your assessment about the impacts of Brexit on the real economy in terms of consumer income?

Then, on inflation, you say inflation is likely to rise to 2% and higher the year after. Is that primarily because of the changes in the position of sterling, or are there other factors that you think are more important in terms of driving up inflation in later years?

Michael Saunders: Let me take inflation. We know from recent cycles that UK inflation is highly sensitive to swings in the exchange rate. We saw that in 2007 to 2009, when the pound fell about 25% followed by an extended inflation overshoot. Conversely, in 2013 to 2015, the pound rose sharply and inflation undershot markedly. In broad terms, if the pound falls, say, 20%—and it is almost down 20% compared to the fourth quarter of last year—you can probably expect to see import prices in the UK rise perhaps 12% to 13% and the level of consumer prices, just on the direct effect of import prices, rise by about four percentage points,



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with that coming through over three or four years. That might be 1% to 1.5% on inflation at the peak years.

In the Bank of England's forecast for August, what you have is a major impact from import prices coming through over the next two to three years but domestic cost pressures still being consistent with inflation slightly below target. That import price effect will be very powerful for two, three, perhaps four years, but it will fade subsequently.

It is important to appreciate that the decision in August to loosen policy against that backdrop is not because the Bank of England is giving up on its inflation target, going soft or aiming for above target inflation. It is because it is trying to look through, to a large extent, that currency impact. Although it is quite persistent in the sense that it takes two to three years, it will fade subsequently. If you tried to offset it fully to anchor inflation at 2% two years out, then you would have unnecessary weakness in growth and would set yourself up for an inflation undershoot further out.

Q15 Rachel Reeves: To finish off on the inflation point before you move on to the current account, you are saying that the pickup in inflation is really a mechanistic result of the fall in sterling.

Michael Saunders: Largely, yes. For the current account, one of the uncertainties over the adjustment of the economy to Brexit is the speed of the long-run effects that the OECD and the IMF argue will come through over about 15 years. It may be that we get less export response than normal from the drop in the pound because of some adverse Brexit effects on the willingness of export-oriented firms to base themselves in the UK. This is something, I would say, on which we are quite unsure at the moment. On the other side, you can expect some slowdown in imports just through slower domestic demand and also, as the price of imports goes up, perhaps some import substitution.

Q16 George Kerevan: Good morning, Mr Saunders. As I understand it, the standard predictive model that the MPC is using suggests that, if the jobless rate falls markedly below 5%, then that will have an impact on meeting the 2% inflation target. You seem to have cast some doubt on that link. Perhaps you could expand a bit on your views on the labour market.

Michael Saunders: Sure. I should note, though, that the Bank of England does not have just one model: it has loads of models for all kinds of different things.

George Kerevan: So it just chooses one to fit.

Michael Saunders: No, it is rather that it uses them for different tasks. On the labour market, the central forecast of the MPC is that the natural rate of unemployment in the UK, the equilibrium, the rate that is consistent with the inflation target over time, is about 5%. That happens to be the same jobless rate we had in the pre-crisis period from 2001 to



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2007. In that period, inflation on average was about 2%. You can see where that 5% number comes from.

Since then, pay growth has repeatedly undershot MPC and consensus forecasts, even though the jobless rate has fallen faster than people expected. I suspect that is a sign that the equilibrium jobless rate is probably lower than it used to be. There is a whole stack of factors at work here. There have been various changes to the tax and benefits system. The level of jobless benefits in the UK is relatively low, and availability has been curtailed. At the same time, we subsidise more people in low-paid work through tax credits. That has probably shifted the rewards for being in work, even if the job is low paid.

There has been a marked expansion in the labour supply, with rising participation rates among older workers but also from inward migration. The effect of this is more downward pressure on pay for any given jobless rate than we used to get. To put it a different way, we should not be seeking to prevent the economy from growing in a way that allows the jobless rate to fall below 5% unless we see clear signs that pay growth is picking up markedly, and at the moment I do not see those signs.

Q17 George Kerevan: The inability of the organised labour movement to control wages, as in the past, and a growth in labour supply from various sources is depressing wages, and that has broken the link between the jobless rate and the inflation rate.

Michael Saunders: I am not sure that it has broken it; I would say that it has moved it. I should add that the flipside of this is that job growth in the UK has been remarkably strong in the last few years. It is not just that we have had lower pay growth, but we have had lower pay growth and, as a response to that, we have had very rapid job growth. The jobless rate has fallen much faster than many had expected and the Great Recession has not left such a scar in terms of long-term unemployment as previous downturns did.

If you look at the split of job growth in the last few years, when you split up the various sectors of the UK and look at industries with relatively low pay levels—that is, at least 15% below the average—they account for about a third of all employment in the UK. In the last five years, those low pay sectors have generated about 75% of the growth in employment, and I think it is a consequence of the greater wage flexibility that we have had an expansion of labour-intensive sectors. Compared to an alternative world in which we had had less wage flexibility and higher unemployment, that has been one of the pleasant surprises of the last few years.

Q18 George Kerevan: Not if you are living on the minimum wage. How permanent is this shift?

Michael Saunders: I am not sure. There have been quite powerful factors pushing down the equilibrium jobless rate in the last few years.



Going forward, two things which might go the other way are possibly reduced availability of foreign workers and the fact that the headline inflation rate itself will probably be markedly higher, as a result of the drop in the pound and the gain in import prices. That might feed through to higher inflation expectations.

Having seen wage growth undershoot repeatedly, I would rather that we assume those factors are likely to continue than always assume that wage growth is about to pick up a lot and possibly, thereby, forgo the chance to run the economy at a stronger pace that allows the jobless rate to fall further.

Q19 George Kerevan: Are your views being taken into account by the MPC? Have you managed to influence them on your view?

Michael Saunders: I am not sure; I am one among nine. That is one where you will have to see how the MPC's views evolve over time. I should add that it would never be just me. The committee has open debates and responds to data.

Q20 George Kerevan: To clarify, if we are challenging a key theoretical underpinning of the predictive model the MPC is using, then is the MPC going to respond to that challenge to its model?

Michael Saunders: I do not know yet. I would hope so, but I suspect it will be the data that persuades people.

Q21 George Kerevan: I think the labour market has structurally shifted quite dramatically across the US and the UK, and it will be semi-permanent. Does that not then lead to a question mark over the 2% inflation target? What would your views be on looking at other targets, for instance targeting nominal GDP growth?

Michael Saunders: There are some advantages to having a nominal GDP target. I must add, first of all, that I do not question the remit. The remit is set for us and I do not in any way seek to criticise it. If you were to think of alternative targets, there are some merits of having a nominal GDP target. Especially at a time of uncertainty over potential growth and the greater risk that you might hit the zero bound more frequently in a low-potential-growth world, a nominal GDP target would automatically compensate by giving you a slightly higher inflation target for a period.

The difficulty of it is that the inflation target framework is quite well understood in the UK, and I would be very loth to tweak it, in case you lose the big prize of low, long-term inflation expectations. Also, the data for nominal GDP are published with quite a lag. The latest we have are for Q2, and so you would always be steering through the backwards mirror a bit. Many of the claimed advantages of nominal GDP targeting can be achieved through a flexible inflation targeting remit, which is what the MPC has.

Q22 Stephen Hammond: Good morning, Mr Saunders. Prior to the



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referendum, of course, there were some fairly clear warnings from the Governor and the MPC, and implicitly the Bank, on the threat to the UK economy of leaving, if we voted to Brexit. Do you think it was a mistake, in terms of either issuing those warnings or the tone the Bank set?

Michael Saunders: I was not at the Bank then and was, therefore, not in whatever briefings the Bank of England was having on this. Let me make a couple of points on that. First of all, I do not expect the Bank to take sides at elections. The independence of the Bank requires us to be politically neutral, so I would not expect us to say, if there is a general election, that this side's policies would have a markedly different effect than that side's.

Secondly, on the issue of the referendum, I was in the markets in the build-up to the referendum vote, and the view that a vote for Brexit would mean weaker growth, a lower pound and higher inflation was pretty much the conventional wisdom. I would not say that it was 100% shared, but pretty close to it. The thing that none of us in the markets knew was whether a possibly sharp movement in sterling in a short period in time would have financial stability implications, whether it would destabilise the financial system in some way such that, rather than just having an economic adjustment, the whole financial system would seize up in a sort of Lehman II moment.

Obviously, outside the Bank nobody has sufficient oversight of the financial system to know as to whether those risks of balance sheet mismatch are real or not. Only the Bank of England is able to look across the financial system as a whole. When the Governor made those comments, what that told me from outside the Bank was that the Bank of England was on top of this issue. If it can see the risk that the currency might fall, perhaps sharply, then it will be scrutinising the balance sheets of financial firms, and thereby ensuring that the system can cope and that it can make that adjustment without seizing up.

That would not change in any sense the economic implications of a vote for Brexit, but it greatly reduced the risk that a vote for Brexit would have a financial instability consequence, which might make the economic effects much worse. I thought in that sense it was very important for him to make those comments.

Q23 **Stephen Hammond:** Do you see the point that has been raised several times, not least by my colleagues around this Committee, that, while you in the markets would have seen this as appropriate oversight and recognition of the risk, others saw this as potentially affecting the independence of the Bank's view? Do you accept that?

Michael Saunders: I do understand those concerns. I do not think it was a desire to position the Bank on one side of the debate. If the issue were to come about again in the future, I would hope that we could find a form of words that you are all happy with.



Q24 Stephen Hammond: In your first answer to me, you used the words, I think, “conventional wisdom” about the potential economic effects of Brexit. So far, those effects have not materialised. If anything, surprisingly, we have had unconventional wisdom in terms of households continuing to consume and unemployment. Do you take the view that one swallow a summer does not make; therefore, one set of numbers a trend does not make, or do you think that the conventional wisdom was wrong?

Michael Saunders: The work by the OECD and the IMF, which are solid, independent groups, argues that the effect of Brexit on the economy is a very long-run issue that will come through over 15 years or so. It is really too soon to tell whether the signs that the economy is holding up better—and I do think that the economy will do a little better over the next few quarters than many people expect—tell you much either way about the long-run effects of Brexit. That applies the other way as well. If the economy were to be weaker or markets to be more volatile, that would not necessarily tell you that the long-run effects of Brexit are any better or worse. It is important not to make judgments on the long run on the basis of short-run data.

Q25 Stephen Hammond: Broadly, you take the view that the first two sets of numbers are not a trend that you are particularly interested in for the implications in the long run.

Michael Saunders: In the long run, yes, but in setting monetary policy obviously what the economy does in the next couple of years is crucial.

Q26 Stephen Hammond: The reason I am exploring this point is because, in your written answer to the questions we sent, you used the words, I think, “slightly lower potential”. That potentially implies your view would be that in the long run the impact of either staying or leaving the EU would have been neutral. Can you define what “slightly lower potential” means, given that we cannot be absolutely certain of what the greater potential over the long term would have been if we had stayed in?

Michael Saunders: There are always uncertainties over potential growth estimates. The OBR in mid-2015, well before the Brexit vote, judged that potential growth for the UK over the next 15 years would be about 2.5%. If that was the case, then you would expect the economy to grow by about 40% over a 15-year period. The work by the OECD and the IMF suggests that a vote for Brexit might lower potential growth by slightly less than half a percentage point per year. That would still leave potential growth comfortably positive, which is why I would describe it as a modest effect over the long run. Obviously even a modest effect over the long run can add up to quite a lot by the end of that period.

Q27 Stephen Hammond: In response to Mr Rees-Mogg’s question, you talked about your view that monetary policy was “unburdened” at the moment; I think that was the phrase you used. In the latest package of intervention from the Bank, there was the introduction of the scheme to



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purchase corporate debt. You obviously talked about distributional changes. Are you worried that the Bank will not ever be able to have neutral buying because there are insufficient UK corporate bonds there; and, indeed, that there is potentially a distributional effect from taxpayers to shareholders that is beneficial to the shareholders?

Michael Saunders: It is still early days to tell whether we will be able to buy the scale of corporate bonds that we set out to do. I have not heard anything yet to say that we will not be able to, but that I think is one that we will have to come back to. Does that just give a transfer to shareholders? I would hope not. I would hope that the effect of those corporate bond purchases and QE in general is partly to lower the borrowing costs through a broad range of companies and that that would give some boost to investment. The evidence is that so far asset purchases have helped to boost growth in the UK and other countries where they have been used, and corporate bonds should contribute to that in the same way.

Q28 **Chris Philp:** Welcome, Mr Saunders. You said in your comments to Rachel Reeves that you thought the inflationary contribution of the weakened currency would peak at around 1% to 1.5% per year. Can you comment on your view as to the non-currency contributions to inflation over a two or three-year time horizon, to give us a feel for your total inflation prognosis over the coming two to four-year period?

Michael Saunders: Currently, if you were to strip out import prices, which recently have been pushing down on inflation, then the growth of UK costs is consistent with inflation being between 1% and 2%, maybe about 1.5% or so, with a sizeable margin of error. That is looking at things like services inflation, the growth of unit labour costs and the GDP deflator, although you have to take some account for the effects of currency swings on export prices for that.

Going forward, I suspect that the growth of domestic costs, if it picks up, will pick up only very slowly. After all, we do not expect the economy as a whole to be growing at an above-trend pace, so the current degree of slack would still be there. There may be some slight upward pressures on pay from, as we were discussing, reduced availability of foreign workers and some feed-through from a higher spot inflation rate to inflation expectations. I suspect that, even over the whole of the next couple of years, the growth of domestic costs would still be consistent with inflation being slightly below target.

Q29 **Chris Philp:** In that context, you are happy that the current interest rate and monetary environment are appropriate and consistent with the 2% target.

Michael Saunders: Broadly, yes. I voted for no change in policy at the September meeting.

Q30 **Chris Philp:** You have mentioned that it will take some time for the effect of Brexit to be fully felt, and you have hinted that there are some



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risks to the downside in terms of the economic impact. If that leads to a weakening in consumer demand and therefore a reduction in the domestic component of inflation, you have no ammunition left, have you, on the Monetary Policy Committee? You have used everything you have got.

Michael Saunders: That is if you just had weakening in consumer spending. I would want to have a look at the broad outlook. Let us say that the growth outlook as a whole is weaker and nothing else has moved, so the inflation outlook is softer. Then the question would be how we would respond. We have said we would cut bank rate close to zero but not below zero, so we have a little bit of room there. Beyond that, the tool would be asset purchases.

I gave a speech in Manchester last week, which I think the Committee has been sent. What I tried to do there was address the question of how powerful cutting bank rate close to zero plus asset purchases could be in providing a boost to growth if the economy does disappoint. This is using simulations on one of the Bank's models, without ever taking those models as being completely perfect. They all come with caveats.

Those simulations suggested that, if the economy was hit by a recession in line with the average recession of the last 60 years, which is a fairly severe one but not as bad as the one of a few years ago, then a combination of slightly lower bank rates and asset purchases could cope in the sense of lifting the economy out of weakness. You would not be able to prevent the weakness from happening, but you would be able to provide a boost, which would get it back on track subsequently. I do not agree with your point that we are out of ammunition. If the time came when we were and when we lacked the monetary policy tools to achieve our remit, I would say so.

Q31 **Chris Philp:** You have alluded to the fact that you would contemplate further QE in the future should monetary conditions merit it. Do you have any concern that the combination of low interest rates and QE over the last five or six years has contributed to a potentially rather unhealthy asset price bubble, particularly in relation to real-estate prices and stock prices?

Michael Saunders: It is hard to know, on this question of asset price bubbles. Over the last few years, equity prices have risen by less than you might expect, given the drop in gilt yields, so the equity risk premium has increased. Of course, that is part of the reason why the deficits of DB pension schemes have gone up, because their liabilities are discounted using gilt yields, and their assets are a mixture of bonds and equities. If equities had gone up in line with the drop in the discount rate, then the deficits of pension schemes in aggregate would have been little changed. I am not sure that I would buy into that idea of a bubble in equities.

Q32 **Chris Philp:** Finally, let me turn to the current account deficit. Are you



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concerned—and I am asking in general terms rather than particularly through the eyes of the MPC—about the size of our current account deficit? If you are concerned about it, what policy response do you think it merits?

Michael Saunders: The main thing that has pushed the current account deficit up in the last few years is the low return on the UK's external assets. It is not that we have had very strong import growth or unusually weak export growth. It is that growth externally has been weak, yields externally have fallen, and that has reduced the money that we have earned on those. For the UK itself, there is really no policy tool that we could have used to address that.

The effect of that current account deficit, of course, is that the UK has needed and still needs to attract large amounts of capital on an ongoing basis. The scale of the deficit may well have been a factor in the drop in the pound. I do not think that we can set monetary policy to try to stabilise the current account deficit as well as trying to stabilise inflation and the economy. You would fall into a familiar trap of too many targets.

Chair: I note that, in your questionnaire, you said the strongest part of accountability for the Bank of England is the requirement that all MPC members appear before the TSC for a confirmation hearing and subsequently. Obviously we will be discussing whether we feel you should be coming subsequently, but that is part of the accountability. Thank you very much for coming to give evidence today. I have no reason to doubt at this stage that this will be the first of a number of times we see you in this capacity. Thank you very much indeed.