

Treasury Committee

Oral evidence: [Bank of England November Inflation Report](#), HC 828

Tuesday 15 November 2016

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Members present: Rt Hon Andrew Tyrie (Chair); Mr Steve Baker; Helen Goodman; George Kerevan; Kit Malthouse; John Mann; Chris Philip; Mr Jacob Rees-Mogg; Rachel Reeves; Wes Streeting.

Questions 1-145

Witnesses

I: Mark Carney, Governor, Bank of England.

II: Mark Carney, Governor; Minouche Shafik, Deputy Governor; Michael Saunders, Member of the Monetary Policy Committee; Ian McCafferty, Member of the Monetary Policy Committee, Bank of England.

Examination of Witness

Witness: Mark Carney.

Q1 Chair: Thank you very much for coming to see us today. I expect today that the lion's share of our hearing will be on MPC business. There is a bit of very important Bank business that we need to scrutinise as a Committee, which only affects you directly. That is your decision to alter the appointment terms in the original exchange of letters that you had with the then chancellor, George Osborne, and extend your intended term of office from five years to six. We are discussing that issue now, rather than whether you are doing a good or a bad job. That is an issue that we look at every time you come before us, Governor.

The issue, though, is what has been going on over this five, six or eight-year discussion. I would like to ask you, first of all, whether you think you have added to uncertainty and brought a good deal of controversy to this extension and to your term of office. In doing so, are you not bringing back much of the uncertainty and controversy that we saw with the reappointment hearing of Mervyn King, when he apparently clashed with Gordon Brown over whether he would get his renewal of his second five-year term? Is that not why we moved to a single, non-



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renewable term of eight years, to avoid exactly this type of controversy?

Mark Carney: I will make no comment on Lord King's reappointment. Let me say, first of all, to be absolutely clear, it is a privilege to have this role. I fully recognise that. It is also an immense responsibility and I was asked earlier this year by the then Chancellor and the then Prime Minister—and others, I might add—to consider trying to fulfil the full eight-year appointment. That was the official appointment that I had, as you know, and I am sure there are some common members still of the Committee when I was first appointed. I was very clear in my testimony about my intention to serve five years but I had been asked to extend that. I said I would respond by the end of the year.

Q2 **Chair:** Tell me: when you were asked, was your understanding that the extension would be for the remainder of your term by statute?

Mark Carney: Yes.

Q3 **Chair:** You decided neither to stick with your five-year arrangement nor to go with the request, which was to return to the statutory provision of eight years.

Mark Carney: Yes, that is correct.

Q4 **Chair:** You gave your reasons, which were to do with Article 50 and the need for an orderly transitional period. Now, what happens if the Article 50 issue ends up being delayed? What happens if there is an extension to the moment at which it is triggered, or the transition lasts longer? Are you going to re-examine this issue?

Mark Carney: Let me give an important piece of context, which is in the public domain but I think it bears repeating. My personal circumstances have not changed. What has changed is the vote to leave and the Article 50 process. As you just said, Chair, my intention is to try to provide as much continuity as possible through that process. It is a hugely important process. We have to get it right. The Bank has to be supportive and I want to help that as much as possible. However, there is a practical reality, which is that I will be separated from my family for that period of extension. Therefore, there are reasonable limits to what that will be. The Prime Minister has been very clear, including subsequently to the High Court judgment, that she and the Government expect that they can meet the original timetable for Article 50. I am not going to speculate on the hypothetical but, to be clear, I have added the year out of a sense of responsibility, to try to provide additional—

Q5 **Chair:** I am going to speculate on the hypothetical, because we have had five years in play, eight years in play and now a decision to go for six.

Mark Carney: That is a reasonable limit that I am going to.

Q6 **Chair:** It is perfectly reasonable for Parliament to ask, and for others who follow your job very carefully to expect, that we now have a definite



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decision. Are you definitely, irrevocably and finally going to be going in June 2019?

Mark Carney: Can I come back to visit?

Chair: Whether some people on this Committee feel that moment is not coming too soon or whether others will deeply regret your departure is not the question we are discussing here. The question is: are you giving us certainty about your future?

Mark Carney: Yes.

Q7 **Chair:** Why did you say, "I am not going to answer a hypothetical question"?

Mark Carney: That is because this is a public hearing and I do not want my words to be interpreted as making a judgment about the likely timetable of Article 50; that is why. It is nothing more complicated than that. I will leave on 30 June 2019.

Q8 **Chair:** Have you considered the effect that the uncertainty that has been generated and the special dispensations from the statutory provision has on weakening the accountability of the Bank? The fact is that we put the statutory revisions in place in order to strengthen the Bank, and indeed that is how it was interpreted. It is your own view that the 2012 legislation had that effect. They were put in place pretty much immediately prior to your arrival, and you have already driven a coach and horses through one part of it twice, have you not?

Mark Carney: First of all, I followed the issues around the eight-year term and the avoidance of reappointment, the process whereby the Governor is soliciting extension or a reappointment and that possibility. I am not saying that ever happened in the past but that possibility or at least that impression could be created. That is the logic, as I understand it, for the eight-year term. I also understand that part of the logic for the eight-year term was the likely diminishing capacity of the Governor over the course of that horizon.

In terms of accountability my view has always been to be clear and upfront. I could have taken the eight-year term with the full intention of leaving in five years because of the factors that I have transparently testified to this Committee in my written and oral submissions in 2012 and 2013. I could have done that but that is not true accountability. I was clear on my intentions. I was clear, as well, after having been asked to consider staying longer, that I would give a view by the end of the year. I have been as clear as possible about why I am extending. I am extending in order to provide continuity, to support this crucial process, and it is no more complicated than that. So, no, I do not think it has added to uncertainty. There are far bigger issues that are adding to uncertainty in the global and UK economies.

Chair: There may be.



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Mark Carney: There are.

Q9 **Chair:** This was one over which you have considerable control, unlike those other ones.

Mark Carney: And there is certainty.

Q10 **Chair:** Did the Prime Minister's party conference speech and her apparent criticisms of central banks, to which you felt the need to respond, have any bearing on this decision?

Mark Carney: No.

Q11 **Chair:** Perhaps I should place this in a wider context. Do you think that the fact that central banks are now responsible for such a huge range of activity, much more than has been the case for most central banks in the 40 years after the war, inevitably puts you in a position where you are more vulnerable and more likely to receive the kind of criticism that some have started to give? I am thinking in particular with regards to criticism of the handling of Brexit and the handling of QE and its fiscal implications. I could go on but those are just two large ones.

Mark Carney: Certainly there are enlarged responsibilities of central banks, and particularly the Bank of England, which has in many respects the broadest responsibilities of any of the major central banks. That means that there is a much wider span of accountability. We are going to be challenged on multiple policies at multiple times. We are going to be challenged on the interaction between those policies and that is entirely appropriate. It is natural that there will be more discussion around our policies. I would add, as well, that it is also partly a product of the time and not just the structure. We are living in a time where monetary policy is in an extraordinary stance, where there is a heavy weight on macroprudential policy and where the economy is subject to big structural forces—I am talking about global forces—and then is about to embark on a pretty major structural reform. It is natural that the confluence of all of those brings different opinion and different challenges, and it is our responsibility to respond to those.

Q12 **Chair:** Do you not think there is a striking similarity between those remarks and the remarks in the apparent exchange that is taking place at the moment between Trump and the Fed?

Mark Carney: No, I do not, actually.

Q13 **Chair:** Trump has been pretty critical of central banks, has he not?

Mark Carney: The President-elect has voiced some views on the Fed and the stance of monetary policy. The issues around structural change are broader. The responsibilities of the Bank of England are much broader. Macroprudential policy is a broader suite of tasks, and so this is a different debate here.



If I may make one point—I am sure we will get into it when my colleagues join—it is very important to distinguish between the stance of monetary policy, the reasons why global interest rates are low and the reasons why inequality has increased across major economies. The last two are caused by much more fundamental factors, and an excessive focus on monetary policy, in many respects, is a massive deflection exercise.

Q14 Kit Malthouse: Good morning, Governor. Forgive me if I ask some questions that you might have been asked before, but I am new on the Committee. I just wanted to ask you a little bit about forward guidance. I found myself a bit confused, which I guess is not the objective. As far as I can tell from the website, there have been two formal forward guidance notices, in 2013 and 2014, but we have not had anything since. There have been some indications. In the August inflation report, the MPC indicated that rates might fall again before the end of the year. What is the status of forward guidance now? What should we construe as being forward guidance?

Mark Carney: Forward guidance is a tool or an instrument, just like bank rates, quantitative easing or corporate bond purchases. It can be used to either tighten or loosen monetary policy on the margin. There have been more instances; let me go through them. As you referenced, 2013 was an example of state-contingent forward guidance. The recovery was just under way. The message that the then MPC wanted to send was, “We will not begin to even think about tightening rates unless unemployment gets to 7%.” That was not that we would then begin raised interest rates. It was just to bind our hand, if you will, over a period of time. The fact is, given the speed of the pick-up in the recovery at the time, historically the MPC would have tightened policy. Subsequent inflation performance indicates that that would have been a mistake. It was the view of the MPC that they wanted to provide guidance to make sure that the recovery that was nascent at the time had legs.

In February 2014 we provided forward guidance about the future path of interest rates. Quite rightly we received challenge from the members of this Committee at the time because our guidance was that we felt that the equilibrium rate of interest had moved down for broader structural reasons, so any tightening of policy, when it came, would be to a limited extent and at a gradual pace. Again, I would say that subsequent events over the subsequent two and a half years have borne out that judgment of the MPC.

Between 2014 and 2015 we provided guidance around likely dispositions of assets. When it became time to dispose gilts or not reinvest gilts in the asset purchase facility, the APF, we provided guidance around that to again guide market expectations about what would be the marginal instrument.



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In August, it was not a form of forward guidance; it was absolute forward guidance that was provided. It was state-contingent forward guidance. At a time of big uncertainty—and I am sure we will discuss where the forecast was and where things have ended up, and the appropriateness of the policy stance we took at the time—we did two things in August. The first thing, which I will not go into detail on, is we aimed off the data at the time. We had a stronger forecast than the data at the time would have indicated, which was one of the reasons why we were at the top end of consensus on the forecast.

The second thing is that we felt the economy would need stimulus, which takes time to build into the economy. If we had strictly provided the stimulus consistent with our forecast we would have cut the Bank rate down to the effective lower bound and potentially provided other stimulus. We did not, because of the degree of uncertainty. We provided guidance that if events unfolded broadly consistent with the forecast in August over the balance of the year, the market could expect the MPC to cut the Bank rate. That was the view of a majority of members of the MPC, although not everyone. That was state-contingent guidance.

I will finish with this. What happened between August and November is that the economy performed better than the forecast. The market gradually took out expectations of that rate cut and, once we got to November and did not cut rates, it was not a surprise. I will add that by giving the guidance in August, we made the stimulus more effective. It had a bigger impact on financial consensus at the time.

- Q15 **Kit Malthouse:** I know colleagues will want to explore the details of what you have said. Just on the phenomenon of forward guidance itself, you are obviously not posting formal forward guidance notices to the website anymore. You are saying that you issued two formal notices, the two earlier ones that were in the section of the Bank's website. You are then saying that the latest is in the inflation report. Quite a lot seems to happen in press conferences. I watched your press conference on the inflation report, and I know there have been a number of speeches that have been construed as effectively forward guidance, which then two or three days later have had to be clarified either by you or other member of the Bank.

Mark Carney: I would not recognise that characterisation.

- Q16 **Kit Malthouse:** The question is: where do we go and look for it now if we want it? Is it actually there? Is it such a dynamic economy that it is moving around a lot?

Mark Carney: No, it is very clear. It is not that difficult. If we have guidance, it is in the monetary policy summary, which is the first page of the monetary policy report. What we have now is a neutral bias. We have got to a position where we think the unanimous view of members of the MPC is that the stance on monetary policy is appropriate. We are still in a position of uncertainty. There are reasons why the economy could



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turn out stronger and inflation could be higher, or the opposite. Rates could go up or they could go down. It is a neutral bias. We are about as explicit as that. That is consistent with the comments—

Q17 Kit Malthouse: I understand that. Forgive me; I am sorry but we are pressed for time. The point I am trying to get to is that it does not seem clear to me what is and what is not forward guidance. Maybe I am a bit thick and I expect foot-high capitals to say, “Here it is”, but it seems a bit buried away now, and I am not sure what is and is not, and therefore whether it is actually operational.

Mark Carney: It is a tool, as I said. It is a tool that is used in the judgment of the Committee in circumstances where it is appropriate. We felt, in August, that it was appropriate. It was very clear what we said in August. I do not think anyone missed it: that if the economy turned out broadly as we expected and forecast, the majority would cut rates. That was right up front in the monetary policy summary, repeated in the minutes, repeated in the press conference and repeated in speeches.

As time went on and as the economy out-performed, which was a very welcome development, you would see in those comments of individual MPC members some nuance around that, which is recognising the better performance. Different members have different views about that, but they recognise that better performance. The market and people in the economy can look at that as well and see that actually the economy is performing better so they are less likely to drop rates by the end of the year. The point is that that was state-contingent. It was understood when it was put in place. It adjusted over the course of the next few months in terms of it being consistent with how the economy performed and it was not a surprise to anyone, or to anyone who was watching the Bank, that when we got to November and had a revision to our forecast, which was material in the near term—less so in the longer term—that we maintained the stance of monetary policy.

Kit Malthouse: I will keep a look out for it in future.

Mark Carney: We will let you know.

Q18 Kit Malthouse: I wanted to ask you one other question about decision-making. At the start of your remarks at the press conference, following the issue of the inflation report, you used the phrase, “What did we miss?” You went through a series of things. Do you ever ask yourself, “How did we miss?” Do you get concerned about the decision-making ability of the MPC? Having had a look at the members—forgive me, because they are all very worthy and highly qualified people—they are all of a type. There is nobody there, as far as I can tell, that has any experience or interaction with small business. I am not aware that there is anybody there who lives in the north. Most of the members or all of the members seem to have come from the banking and financial services sector. There does not seem to be anybody from the manufacturing sector. I may be wrong. I am just reading the CVs that



are on the website. I did not know whether you ever felt nervous about a group-think. I know it is a controversial subject but my guess is that all of them voted to remain in the European Union.

Mark Carney: I do not think you should read that into the record.

Kit Malthouse: Maybe not.

Mark Carney: You should not.

Q19 **Kit Malthouse:** I can make assumptions, I guess. I stand to be corrected. I just worry whether you worry about the group-think of the Committee.

Mark Carney: There are a few questions and they are all very important. The first is in terms of how we learn from events and our responsibility to do continual stock-takes, and at focal points, to see, "What did we miss?" as I said in the press conference. I outlined—and I am sure we will go into detail—what we did think we missed. The core of it is the stronger consumption effectively, which spilled over into a firmer housing market. There is more to it than that but that is the core of the story, and an economy that performed much better than usually reliable survey measures of the economy. We, as I said earlier, had aimed off those. We had forecast a stronger economy than the surveys had indicated at the time of our forecast. We were at the upper end of all forecasters. Many forecasters were forecasting a recession; we were not. We had aimed off, but we had not aimed off enough.

We do an assessment. We also do periodic assessments of our forecast, particularly around inflation, and we publish those as part of the inflation report to see what we have missed and what lessons there are in terms of that. That came out of the Stockton report, something a previous variant of this Committee helped to catalyse before I arrived. We do that, we need to continue to do that and it is absolutely right that we are challenged on it.

In terms of group-think, this is quite a robust structure. It is individual accountability. There are quite different views on the Committee about what is driving the economy. In terms of our core discussions, everything we do is now transcribed. They will be in the public domain; the core analysis that comes to us will also be in the public domain. We publish our minutes contemporaneously with the decisions, so people can see the detail around what our thinking is.

I would take slight issue with the interaction with SMEs. We do spend a great deal of time, individually and collectively, going around the country, all home nations and regions of the country, meeting with SMEs, medium-sized and larger businesses, and people in the third sector as well to understand the dynamics of people, for example, who are heavily indebted. That is in order to build our appreciation of how policy is flowing through to the economy and what is actually happening on the ground in the economy. Personally I go around the country every year



and have these meetings. My colleagues do a substantial amount as well. We have agents in all 12 regions and home nations of the country. They regularly go out and visit businesses. That is the anecdote of the direct contact with business. It is incredibly valuable; you are absolutely right to flag it. We also then do surveys of those businesses, which are conducted by the agents. These include similar questions over time and then special questions, to get a sense of changes in investment intentions, hiring intentions, price pressures, etc. We do spend that time on that. In regions we go out and see.

You were not suggesting this but, just to be clear, we do make policy for the United Kingdom. It is macroeconomic policy; it is not regionally targeted. Obviously if there are difficulties in certain important sectors or important regions and that starts to spill over into the broader economy, we absolutely take those into account, but, as you can appreciate, we cannot target policy for a specific region.

Q20 Chair: It is the case though, is it not, that central banks are masters of Delphic utterances and their capacity to create theology is virtually boundless? That is what people tend to feel might have happened with forward guidance. I would just like to understand a bit more clearly what this neutral position on forward guidance is. Is that no guidance?

Mark Carney: Yes.

Chair: The guidance is that there is not any.

Mark Carney: At the moment there is not guidance on the future path of policy. That is absolutely right. I will leave it as simply as that. However, to be clear, that does not mean that we could not find ourselves in a place in the future where a future MPC does not decide that guidance makes sense. I would add, that the one thing that is still offered is that we do think that the equilibrium rate of interest detailed in this report is very low.

Q21 Chair: At the moment forward guidance does not make sense but it might make sense at another time.

Mark Carney: Exactly.

Q22 Chair: I have now understood it. I think those who most need to understand it understand it. I am not sure that the wider public will understand all of that but I wonder whether they ever needed to understand forward guidance. It was your intention originally, though, that forward guidance should be something that would be understood by the wider economy, was it not? You said that in a speech before you became Governor, which is why we are quizzing you on it now rather than with the MPC. This is something that originated with you, personally.

Mark Carney: Yes, at crucial points that is true. When the recovery just began in 2013, after the worst recession since the Great Depression, we



and I felt it was important to provide context to the general public that just because the economy was starting to grow and unemployment was falling, we were not going to instantly raise interest rates. Remember, this was an economy that was much more heavily indebted at that time than it is today.

Chair: We have made a bit of progress. We are now just going to have a 60-second intermission. Unless other colleagues have any other questions they want to ask you in the context of your appointment or your extension of your appointment. Let us bring in the other members of the MPC. Let us restart and we will go straight to John Mann.

Examination of Witnesses

Witnesses: Mark Carney, Minouche Shafik, Michael Saunders and Ian McCafferty.

Q23 John Mann: Could I just start by picking up one issue, prompted by Mr Malthouse, Governor, on the make-up of the MPC? Considering where we are, is it not about time that a leading trade unionist such as Tim Roache of the GMB or Gerard Coyne of Unite, someone who understands industry should, go and complement others on the Committee with a good industrial background? Would that not help in working one's way through the world we are in?

Mark Carney: I would not dream of advising the Government on who to appoint to the MPC. I would reassure you, Mr Mann, that we do meet with the trade unions. I sat down last month with the senior executive of the TUC to discuss issues of greatest interest to them. Our colleague, Andy Haldane, who is also on the MPC, spoke at the TUC general congress a few months ago as well. As you know, it is for the Government to decide on the composition of the MPC.

Q24 John Mann: Interesting times might need some traditional solutions sometimes, to assist. Last time you were in front of us I questioned you about the scenarios you did before the referendum and suggested that there could be other political elections that lead to instability. That could still happen next year in France or Germany, for example. I wonder whether any of the four of you—and if not I am happy not to hear anything—think that there is a case for Parliament looking at the remit that you have been given and whether that remit is sufficiently flexible or whether it should be changed, and whether that kind of thoughtful debate should be taking place within Parliament at the moment.

Mark Carney: There is merit in reviewing the remit on a periodic basis. I have testified in the past that in Canada every five years they review the remit for the Bank of Canada, in effect. That is in the statute and they come to a new agreement. They make modest amendments; they have made modest amendments over time. It is a good idea, in my



view, to do this periodically but have the periodicity set up front so it is not necessarily a product of this current stance of monetary policy and is not interpreted as something that is relevant to the stance of current monetary policy. It was not formalised in the statute but at the time of the first quarter of 2013 there were some adjustments to the remit by the then Chancellor, which was more explicit about the flexible aspect of flexible inflation targeting, which is something very relevant to the stance of policy right now—this idea of looking more closely at the trade-off between employment, output volatility in inflation and explaining how the MPC is trying to balance that. I believe at that time there were comments to the effect that it would make sense to look at that remit again in five years' time or so. My memory on this is not precise but I believe that was the spirit of what the Chancellor said. My comments are consistent—

Q25 John Mann: Are there any members with a strong view in relation to that, or do you concur? Is it group-think again?

Ian McCafferty: I concur with what the Governor has just said, which is that I think it is the right of this Committee and the right of Parliament to consider the matter.

John Mann: That is a different issue. I am asking whether you think it would be helpful and useful at the moment.

Ian McCafferty: I think a consideration on a periodic basis of the mandate is a very good thing to do. I would say, having been on the Committee when the mandate was adapted in 2013, it improved the flexibility of the Committee, and as such, having had that review, I would agree with the Governor that it should be done on a periodic basis rather than on a random basis; that is probably a good thing. It is a good thing to review, on a periodic basis, the level of the inflation target. My personal view is that 2% is probably right, but at the same time there is a debate to be had about whether that should be changed. Having a periodic review but announced in advance and done on a regular periodic basis, rather than a random basis in response to events, would be beneficial.

Q26 John Mann: Mr Saunders, how can you possibly be doing your job now when you have not got a clue—or I presume you do not have a clue—what the Government policy on Brexit is? I was a strong advocate of Brexit but I do not have a clue what it is or who is running it. How can you do your job?

Michael Saunders: We certainly do not know what the shape of Brexit is going to be. Work by the OECD and the IMF suggests that across a range of scenarios the long-run effect is likely to be somewhat weaker potential growth for the UK. We have not tried to guess exactly which scenario it is going to be. We have just taken an average of a range of them, and then tried to work out how that affects the economy in the near term—that and the associated asset price changes. Your point that



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this makes the forecast highly uncertain is correct. The uncertainty bands in the forecast are wider than they usually have been.

Q27 **John Mann:** You are running away elsewhere, Ms Shafik. You have been promoted into greater things, so you can speak freely now.

Minouche Shafik: I am still very much here. As Michael said, we have taken a neutral stance on what the ultimate nature of the trade relationships will be. We have taken a weighted average of different possibilities and we will review that. Once we get greater clarity on what the future trade relationships for the UK are with the European Union we can have more precision. Until that case, we have these wide fan-charts. Those fan-charts hopefully will narrow over time as we have greater clarity.

Q28 **John Mann:** Are you as much of a bystander as we are, Governor?

Mark Carney: The negotiations with the European Union are the responsibility of the Government. They are formulating their strategy. As my colleague has just said, we have taken a very basic assumption about the medium-term degree of openness of this economy, beyond the forecast horizon, which has some consequences for the path of supply in the economy—productivity plus labour supply. It influences the inflation forecast. To be absolutely clear, the evolution of those discussions with the European Union are not just one of the—if not the—most important determinants of medium term prosperity for the UK—

Q29 **John Mann:** We know that, with respect. There is the question of: who is Government? Some of us, myself included, think it might be more sensible if the Prime Minister, 10 Downing Street and the Chancellor, for better or for worse, were in the middle of driving through what the strategy should be. That would give you direct, soft but regular interaction with what is going on but it is being done by other people in Government, it would appear, where you are at more than an arm's length. I am trying to work out how you could be doing your job if you are not getting clear indication. There is a big difference, in terms of how you do your job, between having a Swiss series of bilaterals as our goal, a Norwegian straight in or, to take the harder extreme, to say, "We are having nothing to do with it," and have World Trade Organization terms. That makes a big difference. You need to get some indication of where Government are going; otherwise you cannot do your job. Who is going to give you that indication?

Mark Carney: This is all to play for. The Government negotiations have not even begun.

John Mann: We are several months in.

Mark Carney: I understand. We have a central forecast that is reasonable, given what we know on likely outcomes—and we do not know anything particularly special that certainly parliamentarians do not know. As this process proceeds, as Dame Shafik says, if we get greater clarity,



we will adjust that and it could be adjusted up or down. It depends on how it proceeds. Let me just make one point if I may, Mr Mann, which is that we are available for technocratic support for all aspects of Departments of Government if they need it as part of this process, and we provide that as needed.

- Q30 John Mann:** On the technocratic support, I have just polled over 2,000 of my constituents, which is a good hit rate, as we might say. What I found is that they voted 70% to leave in my area, so one of the stronger areas. What I found is that 82% of them want the negotiations to include immigration controls, including the vast majority of those who wanted to remain. However, only 17% do not want access to the single market, including the vast majority of those who voted to leave. That might give an indication of where negotiations could go. You are in a very good position, in a totally impartial way, to be showing, if there were immigration controls, what would be particularly useful and what would be particularly dangerous from the point of view of the British economy, and, if there was to be single market access or no single market access, what the consequences, as far as you can see, would be; that would help inform decision-making. You must be doing that kind of thinking through. Is there not a proper role for you to be showing what evidence you have got to help inform us in that debate?

Mark Carney: The proper role for the MPC is to make its best forecast of the economy over the course of the next three years, which is the relevant horizon for the inflation target, and to identify material risk to that forecast and explain those to the best of its ability given the knowledge it has at the time, and to set policy consistent with a return of inflation to target in a sustainable fashion. The types of issues that you have discussed, such as the degree of migration control, the degree of access to the single market and levels of tariffs—and I would add trade arrangements with third countries not in the European Union, which could develop—will have an impact beyond our forecast horizon. There are some echoes of them in the forecast horizon but they are beyond that. It is beyond the horizon of our remit to provide detailed analysis of those outcomes, which, as you know, Mr Mann, is why we did not do that.

- Q31 John Mann:** I have a final short question. Are you meeting with your ECB French and Italian counterparts to look at what kind of stability may be needed if Le Pen is elected a President of France, the Italian Government collapses or Merkel is not elected as Chancellor of Germany next year?

Mark Carney: I would not comment on the specific political events but we are in close and continual contact with our ECB counterparts, with the other national central banks and with the other financial stability authorities on the continent, because we have separately and jointly a technocratic responsibility to promote financial stability. We have to plan for contingencies, and that is including being prepared to support a smooth Brexit process throughout that process, including at the point of Brexit. We are taking our responsibility seriously.



Q32 Wes Streeting: Good morning. I want to pick up where John Mann has left off, by asking a few questions about the Bank's forecasting, the assumptions and the information you might use to make further adjustments to your view. Governor, in your press conference after the publication of the inflation report, you said the markets "have made a much bigger revision to their views of the type of Brexit or the degree of openness that the economy will have, and its consequences for supply and growth, than certainly we have". Could you just elaborate a bit on the difference in the Bank view and the assumptions the markets are making?

Mark Carney: The principal market that has expressed a view has been the foreign exchange market. In the immediate run-up to the referendum and subsequent to the referendum, it has been heavily influenced by perceptions—I would underscore "perceptions"—of the likely degree of openness of this economy, particularly the relationship with the European Union. That does not mean those perceptions are necessarily right at any given time or that they will be fulfilled, and the market will adjust as new information comes into play. Also, I would say it will adjust as it understands better how this economy is adjusting to the prospect of new arrangements.

What we have seen in terms of the direction and scale of the move in sterling is it has been consistent with an expectation of a reduced degree of openness and a slower pace of growth than has been the reaction of consumers, for example. Quite reasonably, the British consumer sees a high degree of job security right now, and wages growing roughly at the same rate as they were at the start of the year. Credit is widely available, and cheap or competitive, and the consequence of that is they are continuing to consume. They are not leveraging up but they are consuming out of income at a fairly solid clip. At some point there will be a resolution of that difference, either through revised expectations of financial markets or an adjustment in consumer behaviour and therefore in the pace of growth in this economy.

Mr Streeting, I am not trying to avoid the question but it is hard to exactly map the level of sterling to an actual growth forecast number, but the direction is fairly clear in terms of the judgement that has been taken.

Q33 Wes Streeting: Again, in your Q&A, you also said that the Bank has changed its forecast to a slightly faster adjustment in output as a result of Brexit, because the Bank has been out talking to businesses, particularly those businesses that have had large exposures to the European Union. What are the key messages coming from businesses? Can you just say a bit more about how that is impacting your judgment? In terms of your own judgments, are you relying on hard facts, i.e. decisions being taken by businesses, or are you relying on anecdotes and assumptions that businesses are making about their view about the various directions the Government might take?



Mark Carney: This goes a bit to one of Mr Malthouse's questions, and maybe I can provide a bit more reassurance around our contact with businesses on the ground and what they are actually doing in response. This is based on conversations each of us would have, as well as our colleagues, with individual businesses and groups of businesses around the country, but it is also supplemented by the work of our agents and the agent survey, which we publish. Broad-brush, in that agent survey, which is detailed in this report—there is a separate publication that gives more detail—it says is that for a little more than half the businesses in the UK, this is a non-issue. They are not adjusting based on the twists and turns of the Brexit process, if I can put it that way. Either they are entirely domestically focused or they are focused on third country export markets. In fact, if they are the latter type of business, the adjustment in the exchange rate is obviously a positive development and they are moving forward.

For about 45% or so of businesses, this is an issue and it is having some impact on their investment plans. For about half of those, it is having a notable impact on their investment plans so they have shelved investments or they are delaying investments. We see that around the country. It goes in a range of industries. One of the industries where we have particular line of sight as the Bank of England—not as the MPC but as the Bank of England—is in the financial services sector, at least the parts of the financial services sector that we supervise, because we know not just what they are doing in real time but also what their plans are, at least at this point in time. That is also part of the information we have used.

We made a minor adjustment, in the broad scheme of things, in this forecast—the November forecast—relative to August about the pace of adjustment to the new trading relationships, because, based on what we have learned from going around the country and talking to various sectors, that pace of adjustment is a little faster than we had anticipated in August. However, I will caution with that, in that I entirely expect that in a little less than three months from now, when we produce our next forecast, we will have learned again, based on another round of industry visits and surveys, and we will obviously update you at that point.

Q34 **Wes Streeting:** Is it your view that, in the absence of any hard facts or knowledge about the Government's negotiating stance, people and businesses are making assumptions now about the type of Brexit we might have and they are making decisions sooner than the Bank would otherwise have expected and maybe they would otherwise have intended if they had had a bit more information about the direction of travel.

Mark Carney: You get a range of reactions from businesses, to be honest with you. On one extreme you get businesses that, as I say, are not exposed to the European Union either through a supply chain or where they sell, or they do not think the demand for their products is exposed to the European Union, either because they are domestic and



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they do not see the connection or they export to third countries. For them, this is a side issue.

There is another set of businesses at the other end of the extreme. Mr McCafferty and I were talking about this, as we have had a similar experience with some businesses, where the view is it is just so uncertain they are going to ignore the uncertainty and just get on with business, if you will, and they will deal with the facts on the ground when they actually change.

There is a substantial proportion of businesses, though, as I have just said in my previous answer, that have started to adjust. Our view is that it is early days. Article 50 has not yet been triggered. The objectives have not yet been set out, nor has there been any sense yet, consistent with those last two statements, of whether there will be a transition period after exit, after the Article 50 process to the end state. Just to be absolutely clear, what I mean by that is I am not talking about staying in the European Union. Sometimes that term can be misunderstood. It is used by different people to mean different things. What I mean is, for example, when there is a financial reform it takes a period of time: the Basel reforms phased in over eight years. The Vickers reforms phased in over four to six years. I will not go on about financial reforms, but the shortest transition period I have ever seen in a trade deal is two years, which was the Swiss-EU deal on insurance. Normally, it is in the range of four to seven years. If that is part of the agreement or the intent, and I would stress it would be in the interests of those remaining in the European Union, not least in the financial sector, to have some transition, then that really informs what businesses need to do today or six months from now because you transition and restructure during that restructuring window. You do not need to do it in advance in anticipation of what agreement the Government ends up striking.

Q35 Wes Streeting: Just before I move on to the issue of the Government's objectives, can I just ask you to elaborate a bit further on the areas you said the Bank has a particular view over, which is financial services? It seems to me from conversations that I have had, and from the various representations we have probably all had from financial services, that there are a number of companies that are already making decisions now that they may otherwise have delayed, for precisely the reasons you have outlined: we do not know what the deal will look like; we do not know if there will be transitional arrangements that would leave a longer period to make adjustments. Could you just describe a bit more, from your particular vantage point at the Bank, what is happening in financial services and the decisions that are being taken?

Mark Carney: My general characterisation would be that the firms with which we are most familiar are making contingency plans. Carve out asset management, although we certainly talk to that sector quite regularly, but banking and insurance writ large, so the core of wholesale finance, and the financial market infrastructure as well, are making



contingency plans. Those contingency plans are at various stages of readiness and degree and specificity. Very few of them are actually implementing those contingency plans, as it is too early to do so. One has a sense, though—and we will have a better sense as time goes on—about the timeline over which, if they follow their plans, those hard decisions would start to be taken. It will depend. I would stress to those firms that it is very early days, so planning makes sense. Action is in most cases, in general, precipitative. Maybe there are individual circumstances where somebody is thinking about winding down a business anyway. There will be anecdotes that are inconsistent with that, but in general it is too early.

- Q36 **Wes Streeting:** That is very helpful advice for them. Based on what you know about the contingency plans that people are making, what advice would you give to Government and Parliament about the timeliness of setting out clear objectives on the direction of travel? Maybe it is unreasonable to ask you to give the Government advice, but you can advise Parliament.

Mark Carney: I was trying to think of ways to effectively say that. Thank you for putting it in. When Article 50 is triggered, there will be context to that triggering and obviously—the Government are fully aware of this—firms, whether they are in the financial sector, manufacturing or agriculture, will start to take decisions, not just with the two-year time horizon but in any other context that is provided to that triggering, whether it is around transition or other aspects of the negotiating objectives, or what other countries say. Those are the facts. It is too soon, I would stress, certainly for the financial sector in general, to be taking decisions about a process that has not yet begun and the Government have not yet—

- Q37 **Wes Streeting:** But you would expect some of those contingency plans to be activated in March if, at that stage, people feel that there is not a direction of travel that would be beneficial to their particular type of activity.

Mark Carney: Things will happen for some firms. For an economically relevant and material degree of activity, I do not think it happens then, based on the knowledge we have then. If the time to exit is measured in 18 months or less, and the degree of exit is viewed as considerable, then a number of those firms would take decisions. That is the best guidance I can give.

- Q38 **Wes Streeting:** I think you used the language of “objectives”. We have had a phony debate around Parliament about how clear the Government should be. The Government are understandably saying they do not want to put all of their negotiating strategy out into the public domain, first, because it is self-defeating, and, secondly, as we learned today, because it does not exist. Surely, in order to undertake your remit and carry out your remit as the MPC, you would need to know what the opening position is or at least what the Government’s objectives are. At what



point and on what basis would you start to change your assumptions? You have said throughout—you said this morning and at the Q&A—that there is all to play for. Negotiations have not begun. There must surely come a point at which you have to begin to make assumptions and adjustments. I am just wondering when and on what basis.

Mark Carney: To be absolutely clear, the MPC will deal with whatever the circumstances. There is no added impetus from the MPC for the Government to be more clear or less clear in terms of the objectives. We will take whatever decisions are made. By the spring, we will be better informed, as others will be, about how businesses are likely to adjust, the extent to which they have adjusted and the speed of that adjustment and the economic materiality of that adjustment. Our forecast will adjust with that. My personal view is there is a pretty high bar for changing the assumption that we have in the medium term about what type of arrangements we are going to get because this will be a negotiation. Trade negotiations, if I can phrase it as that, are never agreed until everything is agreed, and everything is not agreed until one second before midnight.

Q39 **Wes Streeting:** You are using a weighted average of different possible scenarios.

Mark Carney: Yes.

Q40 **West Streeting:** In the context of the technocratic support that you indicated the Bank may need to provide as part of this process, would you be willing to share with Parliament more information about those different scenarios and what the possible consequences would be?

Mark Carney: Candidly, I would be reluctant to. The reason is because it goes beyond. We, as the MPC, have held to discussing, in terms of the forecasting engine of the Bank, the potential impact of the referendum and the risks around the forecast horizon—the horizon that is relevant for monetary policy. We held to that throughout the referendum campaign and we should hold to it now. We are not a forecasting engine of Parliament. In terms of looking at longer-term structural questions, other bodies are able to do that.

Q41 **Wes Streeting:** Of course. I take your point, but it was worth a try. Finally, then, can I ask other members of the MPC, in order to carry out your role and to make appropriate and accurate forecasts and decisions, what information would you expect to receive from Government between now and the end of March, when we expect Article 50 to be triggered, enabling you to carry out your functions effectively?

Ian McCafferty: I do not think we have a list of expectations. We deal with circumstances as they are delivered. There are a whole host of issues which, if we knew more about, we would be more certain of our forecast, not only about the issue of leaving the European Union but also about forthcoming fiscal decisions on the part of the Chancellor or who will win the next election or quite what Donald Trump will do in the



United States. We live in a world of uncertainty. We face at this moment, as Michael has said, significant elevated uncertainty, which is likely to be prolonged, and that makes our forecasting job rather more difficult than it would be in other circumstances, but forecasting is always an uncertain process and we have always taken the view that we will, as the Governor has just said, deal with information as it becomes available and make decisions on the basis of information as it is received. I do not think we have a shopping list of things we need to know before March. We will deal with things as they become evident.

Q42 Chair: Do we take it from that—and you were an economic analyst for many years, for example, Mr Saunders—that you will treat leaks like any other piece of information and will try to assess whether they have a market impact and, if so, what, on the basis of whether you think they are credible?

Michael Saunders: I do not think I would treat leaks the same as any other piece of information. I think I would discount them, perhaps quite heavily.

Chair: But not to zero.

Michael Saunders: It would depend on what the leak is and where it comes from.

Q43 Chair: We know what we are talking about. We are talking about the Brexit Committee. Every time it meets, it leaks, so we know exactly what we are talking about. The Government say they do not want to say what their position is until next March but we almost certainly will find out the day after the Brexit Committee meets each month or week.

Michael Saunders: But we would not even know at that stage what the eventual outcome of the Brexit negotiations will be.

Chair: That is a different point, and that is another uncertainty, to which Mr McCafferty has just referred. I am not referring to that one. I am just referring to this one uncertainty on the basis of Wes Streeting's question.

Michael Saunders: I do not think we are trying to tweak our Brexit assumptions from day to day, according to the ebb and flow of news. If things change in a major way and we have much greater clarity on what the eventual outcome will be, then at that point we would discuss among ourselves whether to change it, but it is not something where I would expect that we are just going to bounce around from day to day or week to week.

Q44 Rachel Reeves: Mr McCafferty, you just said that the Bank of England will respond to circumstances as they are delivered and of course Brexit is not by any stretch of the imagination the only uncertainty that exists out there. There are many other uncertainties, so I entirely concur with you that the job of the Bank of England is to respond to what happens in the economy and indeed, even if the Government were to publish exactly



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what the negotiating strategy was, it would not necessarily help you that much in that the Government might not be able to deliver what they are setting out to deliver. Even if you had all that information, I am not sure it would be that useful as a guide to what the end point would be.

Building on what the Governor has said about the analysis that the Bank is doing, it is clear that over the time leading up to the triggering of Article 50, and over the two years after that, during negotiations, the Bank will need to look at what the likely impact on inflation and growth, etc, would be in the event of different end points. You said, Governor, in your answer to Mr Streeting, that you do not think it would be that helpful to publish that information. However, ahead of the referendum you did, both in the inflation report and in other ways, put forward the Bank's concerns about different scenarios. I would have thought that the same exists now, and it would be useful to put into the public domain your assessment of the impact on inflation and growth of different scenarios. Do you not agree, Governor?

Mark Carney: With the risk scenario we talked about in the May inflation report, to which you just referred, we did that because we saw that as the biggest risk to inflation over the horizon, and we did it because we wanted to get across how the response to a decision to leave in the near term could affect the path for inflation and what the channels were and the fact that the monetary policy response would not be automatic. That was the term we used. I would say directionally we have seen, over the course of the subsequent six months, exactly why we said that, because it depends on the balance of the effects on exchange rates, on domestic demand and ultimately on supply. You are asking a question, ultimately, about supply: what are the risk scenarios under different arrangements with Europe and how could that affect inflation?

I can only repeat my comment to Mr Streeting: I am reluctant to develop that medium or longer-term forecast that is beyond our horizons. The understanding, amongst those who watch the Bank and the Bank's policy, of this balance between these three factors has increased. We are using that framework to explain both our forecasts and our stance on policy and we will continue to do so. We are flagging risks to that. At present, net for inflation, those risks are wide but balanced, so the tails are fat but they are balanced. It is possible we will provide more commentary and associated analytics around that, particularly if those tails shift. In other words, if there becomes a skew, either on the upside or downside, to inflation because of these potential developments. I would expect, just as we did in May, that we would stop short of a full forecast of an alternate scenario.

Q45 **Rachel Reeves:** We are definitely leaving the European Union. My constituency voted to leave and I respect that decision. I accept and understand that we are leaving the European Union. However, I also believe that what that means could be a whole range of different scenarios and what I want to ensure now, for my constituents and for the country as a whole—and I think that all members of the Committee would



agree with this—is that we get the best possible deal for us. To work out what that best possible deal would be means having more information than we currently have, and the reason I am pressing you on this, Governor, is that having more information about the economic impact of different economic scenarios is important, but it is not the only factor we need to consider when we think about leaving the European Union. There are other issues apart from economic issues for leaving the European Union, but I think our constituents and people would be very interested in understanding the impact of different forms of exit from the European Union.

Mark Carney: I appreciate that. No one is in any doubt about the path that has been taken. What we have to focus on as a committee is how that path affects inflation over the course of the next few years. The ultimate economic impact of the future relationship with Europe and the future relationships with the rest of the world, made possible by that future relationship with Europe, will be realised, as you know, well beyond the forecast horizon. The economics of this are beyond the horizon over which we forecast. That is why I am hesitating because we would be drawn into forecasting something that is a seven-to-10-year forecast, and implicitly a path to that, which has never been the role of the Bank and certainly not of the Monetary Policy Committee.

Q46 **Rachel Reeves:** It may have an impact beyond the forecast horizon.

Mark Carney: It certainly will.

Rachel Reeves: I agree with you, but it also has an important impact within the horizon. I wonder whether any of the other members of the MPC would like to comment.

Minouche Shafik: As the Governor said, we already have a very wide remit and many powers, and going beyond those might not be appropriate at this juncture.

Q47 **Rachel Reeves:** I am not asking you, Dr Shafik, to go beyond the powers. The Governor has already said that the Bank will be looking at these things. All I am suggesting is that these would not only be useful for economists and decision-makers at the Bank of England but they would be of interest and useful for others as well.

Minouche Shafik: The point I want to make is there will be many other bodies out there—think-tanks, academics, policy people—who will be thinking about that longer-term seven-to-10-year horizon in which one has to actually look to assess this properly. I appreciate that you are keen to have as much good analytics to support important decisions but it might be better to look elsewhere, at other bodies, to do that, rather than to us, as our work has to be very much contained by our mandate.

Q48 **Rachel Reeves:** But if you are doing the work anyway—we can Freedom of Information it, I guess—it would be useful to have it in the public domain.



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Moving on to the issue of inflation and today's inflation numbers and the inflation report from earlier this month, inflation fell to 0.9% in October, from 1% the previous month. Were you surprised, Governor, by the fall in inflation, because people reading news stories about Toblerone or Marmite or Microsoft might have thought that there was only one way inflation was going, and that certainly was not downwards.

Mark Carney: Inflation was lower than we expected for the month of October. The principal reason is clothing and footwear, which was the biggest downside surprise on inflation relative to expectations. As I think you know, that is a very volatile component. It is heavily influenced by weather and changes of season and people, on a day like today, not having to go out and buy a warm coat. Those type of short-term effects are there. In terms of the direction of inflation, there is nothing in this release that suggests, to me at least, that inflation is not going up. Inflation is going up. The pass-through from a 20% fall in the trade-weighted level of sterling is going to come. It is going to build towards the end of this year into 2017 and, in our expectation, will be above 2%, certainly by the middle of 2017, and stay there for a while, because of that pass-through.

As an individual, I would not take a steer from the October numbers to say that was all just noise. No, unfortunately, inflation is going to go up. That is the consequence of a very large move in the exchange rate. The decision we have to take as a committee is how we react to that. Do we push inflation down, at some cost to output and employment, or do we look through it, given the causes, in order to get a better outcome for the economy.

Q49 **Rachel Reeves:** Thank you, Governor. Mike Prestwood from the Office for National Statistics said this morning that, aside from fuel, there is no clear evidence that these pressures—i.e. from the exchange rate—have so far fed through to prices in shops. What we also saw in the published numbers was producer price inflation of 4.6% and imported goods prices up 14.1%. You said, Governor, that it is only a matter of time before these filter through to the Consumer Price Index. Do you think that there is any new information in the numbers that we have seen today, or should we just look through—

Mark Carney: There is always some information. It came out literally half an hour before we came in here so I have not gone through it in any detail. We will get detailed staff analysis on it. Maybe take a step back. You are absolutely right to flag the PPI number, which is stronger than market expectations, and would be consistent with the first stage of exchange rate pass-through. Just to remind you, although you know this, there is the phase of the price of imported goods going up. Normally about 60% of that is pass-through and then it is about how long it takes and to what degree it passes through to consumer prices, so what people actually see in the shops. It is that that really matters.

Rachel Reeves: Sorry to interrupt, Governor, but when you say there is



60% pass-through from imported goods price inflation to consumer—

Mark Carney: Of the exchange rate fall to imported goods prices. In some cases people stick with, effectively, the sterling price. Somebody who is exporting sticks with the sterling price. If they tend to price in dollars, they just stick with the dollar price. A lot of things are invoiced in dollars.

Q50 **Rachel Reeves:** Over what time horizon is that 60%?

Mark Carney: It is pretty quick. There are some lags but let us say within the first six to nine months. Then we have to make a judgment—and we did make an important judgment as a committee in our forecast—as to how long and to what degree that flows through to consumer prices, so what people see in the shops, in aggregate rather than individual products like Marmite or Toblerone. Our research shows, and international research shows, that if the movement in the exchange rate is likely to be caused by a hit to supply, so future productivity potential, that pass-through of inflation tends to be quicker. That is the first point.

Secondly, in the UK, pass-through tends to be pretty substantial but also protracted. We took the combination of those two and we have more of that inflation coming in in 2017, so we see a hump in 2017 and 2018, and then a tail in 2019. That is new in that, let us say 10 years ago, and certainly five years ago when we had the big depreciation post financial crisis, the thinking was, “Actually, there is not much pass-through”, and so the expectation was it would largely have been taken at margins. At the time, the forecast of the MPC was that inflation would not go above target and look through. We think that what is going to happen is this is going to go above target. We think it makes sense to take that real adjustment in incomes, because that is what is going on here: the purchasing power of the country has gone down because the exchange rate has gone down. It is better to take that in a little bit of inflation with more people employed and nominal wages growing a bit more, than doing the opposite and squeezing it out and taking much higher unemployment. Am I allowed to repeat that there are limits, though, to that, if I may?

Q51 **Rachel Reeves:** I want to come on to that in a minute, Governor. I do just want to explore in a little bit more detail the numbers that we have seen today, before we talk about whether you will tolerate higher inflation because of other costs. In today’s numbers, of the 0.9% for CPI and then the PPI and the import goods price inflation, which one of those do you think is the most interesting or the most useful for thinking about future pressures or future direction? You are steering us away from taking that much of an interest in the headline CPI number. You think the other numbers tell us more about the direction of travel?

Mark Carney: “Yes” is the short answer. There is a slight note of caution; I have not seen the broader measures. Core inflation is a little softer as well and that excludes food, alcohol, tobacco and energy but it



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would include clothing and footwear, so I suspect that that is the main reason it is softer but I need to check it.

Q52 **Rachel Reeves:** You say that the pass-through to CPI is quite quick: six to nine months.

Mark Carney: The pass-through to import prices, not to CPI. The pass-through to CPI is quite slow and protracted.

Q53 **Rachel Reeves:** The pass-through to import prices would be reflected then in the 14.1% today. The fact that it is not feeding through so far to CPI—

Mark Carney: It is coming.

Rachel Reeves: The fact it has not fed through so far, is that because retailers are absorbing those increases in costs at the moment?

Mark Carney: Here is another example, if I may. We met with all the major retailers in the UK yesterday and talked about, amongst other things, exactly this issue. Of course most of them had been hedged. They had six or 12-month foreign exchange hedges, so during this period they can absorb these types of costs because they have the foreign exchange hedges. Those hedges run out; they have to put hedges on at the new lower rate and then you start to see pass-through. Of course, as you know, this is one of the most competitive, if not the most competitive, and innovative retail sectors in the world, and so what they are doing now is trying to figure out how to take out other costs and absorb as much as possible, but inevitably some of this big move will be passed through, and that is reflected in our forecast.

Q54 **Rachel Reeves:** Why do you think we have seen some of the newspaper stories over the last few weeks about Marmite and so on? Is it just that there was just a small number of products in a few shops? Why have none of those stories we have been hearing about shown up in the data?

Mark Carney: A small number of products, effectively. More generalised consumer price inflation, as I say, is coming. We do want it back towards 2%. We are willing to tolerate an overshoot for broader reasons, and I am sure we will discuss that in more detail.

Q55 **Rachel Reeves:** Let me just then finally ask you about tolerating higher levels of inflation. That, of course, Governor and other MPC members, has limits. In the inflation report, you have inflation going to 2.7% at the end of your forecast period, I believe, which is not that much higher than the target. What would you tolerate?

Mark Carney: First, on the actual inflation profile, it goes up to around 2.8% and then it starts to tail down in the last year, so down to 2.5% by 2019 and then further down, offstage, if you will. There is no precise number. It depends why inflation is moving and we are more likely to accommodate an overshoot if any of the following, or collectively the following, are there: if the exchange rate has moved for fundamental



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reasons, because supply has reduced and it is part of the investment process; if there is a considerable degree of slack in the economy, so there is a countervailing pressure, which certainly was the case in 2010 when the committee took those views; and very importantly where inflation expectations are. Expectations are well anchored so we are watching those quite closely.

Q56 Kit Malthouse: I just wanted to follow up on some of the specific issues around inflation. One of the things that I could not find much consideration of in your report was the accelerating deflationary effects of the internet and a much more global and fast-moving supply chain. Thus far, there seems to be a difference of view—or maybe not—between you and the ONS about where the inflation is coming from at the moment. They seem to be saying it is largely domestically generated and there is no indication in the numbers that have come through thus far that it is coming from depreciation of sterling, and yet that seems to be the key thing you are fixing on. It is purely this delay, you are saying.

Mark Carney: It is the timing issue. That is right. Technically, we should be at the tail end of getting some deflation from the last big depreciation of sterling given the lags I suspect. We are not actually seeing that. It is timing. Part of the benefit of talking to businesses is that one knows that they hedge things out, and that is part of the reason it takes time to flow through, or they are taking countervailing measures. To your point on the internet, of course that is one of the structural trends in retailing that is likely—again based on intelligence from talking to a wide range of businesses and retailers, not just yesterday but over time—to be reinforced by recent developments. Without question, we look at the structural changes and so in 2000 the big structural deflationary force was the integration of China. More recently it has been, let us call it, the internet, robotics and the adjustment to a supply chain that comes from manufacturing goods.

Q57 Kit Malthouse: I could not find any consideration of it in the report. For instance, if you look at the energy market, 94% of people in the energy market who do not shop around pay way more than they need to for their fuel. If the acceleration in shopping around continues at the rate it is now, or becomes elliptical, then we could see massive deflation in energy costs.

Mark Carney: If that happens we would take it into account, but there is no evidence of it happening. If there is structural change in that market or structural change in consumer behaviour consistent with that, or competition in that market, we would take it into account because it is significant. The point I would make is that we look at structural issues, but if they are structural and they are in place and they are multi-year trends, it does not make sense to look at them in every single report because the trend is there and it is baked in.

Q58 Kit Malthouse: Just one other question, then. I gather from colleagues that in the past you have said that the connection between the money



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supply and inflation is tenuous. I think that is the word you might have used in the past.

Mark Carney: Non-existent.

Kit Malthouse: Okay, driving a coach and horses through 40 years of economic theory, but nevertheless—

Mark Carney: There is lots of economic theory.

Q59 **Kit Malthouse:** I find that strange because one of the things it says in your report is one of the exit possibilities from QE, or the dampening of inflation, is not just raising interest rates but also asset purchases, to reduce the money supply. As early as 2009, in one of the quarterly reports, QE was specifically positioned as helping you reach the 2% inflation target because it was increasing the money supply and similarly you are saying as a resolution to inflation you could contract the money supply. I am concerned about this: that you are saying there is no connection when you are positing it as a solution.

Mark Carney: There is a very erratic relationship between monetary aggregates and inflation in the UK. Yes, an economic theory is there and a Nobel Prize is associated with it, but I would suggest that not all economic theories stand the test of time and Nobel Prizes are given for a broad body of work as opposed to one idea. Our view on the way QE operates is it not a question of monetary aggregates; it is a question of portfolio balance channels, i.e. the effect on overall economic conditions by the purchase of assets and, if you will, the displacement of those who sell the assets into other assets—

Kit Malthouse: I understand—

Mark Carney: This is important. It is distinct. It has the consequence of the money supply increasing, but regarding the money supply that increases as part of that, these are reserves of banks whose only use is settlement of accounts with the Bank of England. This is a crucial point.

Q60 **Kit Malthouse:** The 14% rise in July just happens, therefore, to be coincidental with the general increase in sentiment about inflation?

Mark Carney: According to the monetary theory, the price level should be coincidental with an acceleration of inflation. What we just learned this morning was that inflation did not accelerate. Two factors drove that increase. One is that the M4 we look at strips out interbank activity, so we look at M4 ex all of that, so it is a lower level of growth. What we see in terms of that increase was an increase in household cash balances in investment funds and in businesses, so consistent with precautionary behaviour, so people moving things out of riskier assets into less risky. Now we would expect, certainly for households, and in fact consistent with the forecast here, which has declining savings rates, that those households would move and are moving those cash balances into the economy, which is one of the things we think is supporting the economy.



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Q61 **Chair:** We have lingered a little on this but I think we might have to linger a lot more on this issue about whether there is a relationship between the money supply and inflation, but I do not think we will do that today. I just want to ask you one question about the exchange rate before moving on. Was the fall in the exchange rate a welcome change for the UK economy?

Mark Carney: The UK economy, in general terms, showed some signs of having a large external imbalance and that large external imbalance was represented by a large current account deficit. It needed to be righted over time. The exchange rate is part of that adjustment mechanism. Can I say one more sentence? One of the questions is about the fact that it is extremely difficult to estimate a sustainable level of the current account. Now I am going to put a semi-colon, so I stay in one sentence.

Q62 **Chair:** We have understood exactly what you are trying to say, which is that you cannot just use the current account without disaggregating its various parts and also finding out how it is funded.

Mark Carney: Directionally a depreciation in the exchange rate, consistent with moving towards better external balance—one of the questions is whether the future relationship with Europe and the rest of the world means that that sustainable level of the current account has gone down.

Q63 **Chair:** Okay, so can I just go back to my question. Having made that assessment about the current account, was this fall in the currency welcome or not?

Mark Carney: It was necessary.

Q64 **Chair:** So you think that we are in a better position now than we were before the currency fell, so it would be welcome.

Mark Carney: That is a partial question, if I may.

Chair: It is fairly simple.

Mark Carney: We are in a position where the purchasing power of the country has gone down by 20%. That is a product of a number of factors.

Chair: You just said it is necessary.

Mark Carney: The direction of the currency move was necessary.

Chair: Necessary but unwelcome?

Mark Carney: If we were sitting here a year ago, directionally a few things needed to happen in order to move to a more sustainable current account over time and one of them would have been an adjustment to the currency. The preferred adjustment would have been a surge in domestic productivity, but that is not to comment on the scale of the currency move that has happened.



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Q65 **Chair:** Let us do that. Is the scale of the currency movement a welcome change?

Mark Carney: Future events will determine whether it is appropriate.

Q66 **Chair:** I am sure history will tell us eventually, but I am asking you whether it was a welcome change. It is a fairly reasonable judgment to ask a central bank governor to make.

Mark Carney: Not without the appropriate qualifications—not of the central bank governor but of the answer—which is that the scale of the adjustment in the currency, I think I am safe in saying, presumes a notable reduction in the degree of openness of this economy and a slower path of productivity. Those two assumptions are still assumptions. They are expectations of the market and are baked into the market, but they are still just expectations and what happens between now and when the UK leaves the European Union will have a tremendous impact on the validity of those assumptions, so it may not be at the right level.

Q67 **Chair:** Can you think of anything that is unnecessary but welcome?

Mark Carney: I will write to the Committee.

Q68 **Chair:** I only point all this out because in using these phrases—“a welcome change”, “we need to be back to the level where we were in 2013” and “we are in a better position”—I am quoting Mervyn King in his interview on 24 August, and I just wonder whether you welcomed the intervention of your predecessor in this debate on the currency.

Mark Carney: I am always interested in what Lord King has to say.

Q69 **Chair:** We all are, but I am asking whether you welcomed it.

Mark Carney: It was unnecessary but welcome.

Q70 **Chair:** This is a pretty serious matter, really, is it not? After all, he was the central bank governor who told us how grateful he was to his predecessor that he did not intervene and that he had not spoken up. Indeed, on the record, there is an extremely powerful quote to that effect. It does not make your life any easier, does it?

Mark Carney: Part of openness and accountability of the Bank is that everyone is free to comment on economic circumstance and the Bank’s policy.

Q71 **Chair:** Are we going to be hearing from you in July 2019?

Mark Carney: No.

Chair: We note that.

Q72 **Helen Goodman:** The remit of the Bank is to promote monetary and financial stability and, as I understand it from the answers you were giving to Wes Streeting and Rachel Reeves, you do have a view on the way different approaches to Brexit would impact on achieving that



objective. Is that right?

Mark Carney: With respect to monetary stability, as we have said for more than a year, whatever the future relationship between the UK and the rest of Europe, we will be able to achieve our monetary remit. In that regard, it will have a bearing in terms of the level of GDP of this economy, and potentially the level of employment for some time, but not on our ability to achieve the inflation target.

Q73 **Helen Goodman:** Earlier on, as I understood it, you were saying that your conversation with the Government about the Brexit negotiations does not just consist of you listening to what they have to say; you also have something to say to them about the implications. Is that fair?

Mark Carney: As you would expect, I have regular conversations with the Chancellor on matters of monetary and financial stability, shared understanding of the outlook for the economy, potential stance and policy, and that will always continue. That is a two-way conversation. I would characterise our conversations with the Government, though, as the Government ask us questions and we respond to those questions, not that we go and volunteer perspective or analysis.

Q74 **Helen Goodman:** If the Supreme Court decides to uphold the decision of the High Court, the decision to trigger Article 50 will come to Parliament—it will not be purely done on the Royal Prerogative—at which point we may want to ask you your views. I can see that before the Supreme Court hearing you might be reluctant to do that, but would you like to consider now that you might be asked for a view from Parliament in that eventuality?

Mark Carney: For other reasons, I have been refreshing my memory of my first hearing in front of this Committee, at which the Chair asked that we respond to all reasonable requests for information, so if it is a reasonable request for information we will respond, yes.

Q75 **Helen Goodman:** Thank you very much. Dr Shafik, we have asked you collectively questions about quantitative easing over the last 18 months, and on 15 September Mr Kerevan, Mr Baker and I all spoke in a debate in the main Chamber and expressed our concerns about it. Today I want to concentrate on asking you a few questions about the corporate bond purchase scheme on which you have embarked. The Bank's inflation report states, "Narrower spreads will have reduced the cost of issuing sterling denominated bonds and supported issuance for these companies." I am assuming that you agree with that and I want to ask you whether you think it gives some companies advantages over other companies, and whether it can have any distorting effect on competition?

Minouche Shafik: We are quite pleased because we have watched what has happened to spreads, both of firms that are eligible for corporate bond purchases by the Bank of England, and those that are not eligible, and they have actually moved together. There does not seem to be any evidence that it has benefited some more than others. In fact, it seems



to have lowered spreads in a much more widespread way, so that is a reassuring sign. The other reassuring sign is that the issuance in sterling has gone up. We had been through a period, prior to our announcement, in which UK corporates were not issuing in sterling any more at all. In fact, the market had completely dried up. It was much cheaper for them to issue in euro and then swap back to sterling. Since we announced the corporate bond scheme, we have actually seen a substantial increase in the corporate bond market and that market has been revived.

Q76 Helen Goodman: Why do you think that is a good thing?

Minouche Shafik: It is obviously good to have a local bond market in terms of financial stability. Obviously, UK firms that are globally focused will operate globally and will borrow in multiple currencies but it is useful for many firms to be able to borrow in their local currency. If you look, for example, at the list of 33 additional bonds that we declared eligible for our scheme, many of the new additions are universities, housing associations and small local utilities, for whom borrowing in multiple currencies would complicate their lives enormously. The fact that there is a vibrant sterling corporate bond market is advantageous to them.

Q77 Helen Goodman: That is a very fair point. There was some controversy about the people who you put on your list, particularly initially. People can see why a housing association makes a material contribution to the British economy, or a large manufacturer like GSK, but people did raise their eyebrows with Apple and Pepsi. Do you think that the definition you used of "material contribution to the British economy" was too broad when it includes firms like that as well as the other ones?

Minouche Shafik: Our primary objective when selecting the firms that were eligible was to replicate the market. We did not want to be in the business of allocating credit and distorting the market in any way, so it was very important to us to have a somewhat mechanical approach to choosing which bonds would be eligible. The criteria we used, "material contribution to the UK economy", "incorporated in the UK", "have a significant number of employees in the UK", was applied mechanically. We have our independent second-line risk function, with a committee that goes through eligible bonds, and they applied those criteria mechanically.

Q78 Helen Goodman: What was your cut-off for the number of employees you needed to have?

Minouche Shafik: We look at employees, but we look at other criteria. For example, if you are incorporated in the UK and have fewer employees but you pay tax in the UK and your operation is in the UK, you might be eligible. There is not one mechanical cut-off. It depends on multiple criteria. If you are not incorporated in the UK, you have to have a lot more employees.

Q79 Helen Goodman: So you did take account of what corporate taxes people have been paying.



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Minouche Shafik: “Incorporated in the UK” meant you would be subject to that. We did not look at actual tax payments but being incorporated in the UK would be consistent with making a material contribution.

Q80 **Helen Goodman:** I can see that because Northumbrian Water are domiciled in France, I think, and therefore are not paying tax in the UK. Governor, do you want to say something about that?

Mark Carney: You can look at it from two perspectives. You can look at what is screened in, but it is also useful to look at what is screened out. We screened out any financial firms that we supervise, so there is no actual or perceived conflict. We would not want to be in a position where we are buying a bond of a bank that ultimately gets bailed into that bank, to state the obvious. We screened out those. There are a number of issuers—more than a handful—who are basically financing vehicles for global corporations and they have issued in sterling as an arbitrage because it is cheaper funding. Buying those type of securities that ultimately benefits outside the UK is what we try to avoid. In the auto sector, there are some auto companies that are active here and issue in sterling. We buy their securities. There are others that use it as a funding vehicle and do not have activities and we do not buy their securities, as per the example. Broad-brush, though, is contribution to the UK economy and looking to replicate what is in the market already and adjusting our auction procedures so that we come up with a representative sample of what is in the market, so we are not making the credit allocation decisions.

Q81 **Helen Goodman:** I think people were also slightly surprised that you were buying bonds for the airports in Birmingham and Manchester, but not Gatwick. Was there any particular reason for that? There has been some comment about that in the press.

Minouche Shafik: They have to be investment grade, and they have to have a certain time period left to run, so it would not have met some of those criteria.

Q82 **Helen Goodman:** What consideration have you given to the purchase of equities?

Minouche Shafik: That is not currently part of our strategy.

Q83 **Helen Goodman:** I know it is not, but why?

Minouche Shafik: Purchasing equities is a much more complicated business, not from a buying point of view but from managing the consequences of owning equities. You have to participate in shareholder decisions; that gets very complicated. Some of the risk management issues are more complicated. It is not something we have said we will never do but at the moment it is not part of our plan.

Mark Carney: I entirely agree with that. I would make two additional comments. One is that the issue is moving out the risk spectrum. To the



earlier discussion on QE and the displacement effect, if you are buying gilts you displace people, either into longer gilts or into corporate bonds, equities, foreign exchange, etc. The next step from gilts logically would be corporate debt securities; you are displacing those people into either riskier corporate debt securities—high yield securities is the example Dr Shafik gave—or potentially into equities. The way I view it is you do not jump to equities as your first step.

The second point is, just for the avoidance of doubt, we have a balanced risk assessment, neutrally biased to monetary policy. We are not in active consideration of expanding our programmes. We just took a decision. My personal view and the view of the rest of the MPC was that the stance and policy were appropriate. I would not want anyone to read into a hypothetical discussion a signal on policy, because there is none from us.

Q84 Helen Goodman: Mr McCafferty, you spent a long time working in industry. I wonder what your thoughts are on this corporate bond programme.

Ian McCafferty: I supported the corporate bond programme in August when we announced it even though I voted against the package of quantitative easing at that point. That decision was on the basis of the total quantum of stimulus. I did not want to provide at that stage quite as much stimulus as other members of committee and therefore voted against that one element of the package. In spite of that vote against QE itself, I voted for the corporate bond package on the basis that we had seen a widening of spreads between government bonds and the corporate sector. I did feel at that stage, given some of the potential pressures on the corporate sector, that the uncertainty was bringing about—Minouche has already talked about the drying up of corporate bond issuance over the course of the spring in sterling terms—actually providing assistance to that area of the market and therefore bringing down the spread between corporate bonds and government bonds back to its previous levels would be beneficial.

Q85 Helen Goodman: Another criticism has been the impact in particular on defined benefit pension schemes and I want to ask you about this. Are you not concerned that the increase in deficits of these defined benefit pension schemes, which has been made larger—not caused by, but made larger—by the programme of QE is proving to be somewhat counter-productive in that, if firms are having to put money into their pensions schemes, that is money that they no longer have to invest in productive capacity or to pay their employees more. Dr Shafik, what you like to comment on that?

Minouche Shafik: First, it is important to say, to scope the problem, that the impact of lower interest rates and QE on defined benefit pension schemes does not affect those who start off from balance, because the impact on their assets and liabilities balances out. It really only affects those that initially start with a deficit.



Q86 Helen Goodman: You yourselves in the inflation report have pointed out that that is 80%. This is a non-trivial point.

Minouche Shafik: Yes, that is correct, but also to say that the proportion of workers who have defined benefit pension schemes is obviously also shrinking over time as most of the private sector is moving away from that. It is still a huge issue in the public sector, as you well know.

Q87 Helen Goodman: Are they not moving away from it because of the size of the deficit? They are not moving away from it because people do not like having security about their retirement income. They are moving away from it because of the affordability problem.

Minouche Shafik: People are living longer and it is harder to predict the kind of returns you will be able to generate. In terms of the question of the impact of monetary policy on defined benefit pension schemes, the impact will vary over time. We saw a deterioration in the deficits earlier, after the initial package in August. More recently, some of those deficits have shrunk. It will vary over time but the medium-term objective is of course to have an economic recovery so that asset prices recover and those schemes can then generate capacity to reduce those deficits. That is what we need to keep our eye on in the medium term, rather than changing the whole shape of monetary policy to try to deal with a more specific issue.

Q88 Helen Goodman: I know that is the objective and I know that it does have that impact, but this is a countervailing pressure and when Tesco's deficit rises from £3.2 billion to £5.9 billion and British Telecom's rises from £6.6 billion to £9 billion, these are pretty chunky numbers that are highly likely to impact these large organisations that employ a lot of people. Surely that is the case?

Minouche Shafik: Absolutely. We are monitoring those numbers very carefully. The MPC has spent a lot of time looking at the impact on defined benefit pension schemes. We have done a lot of analytical work. We have had joint meetings with the FPC to look at this issue and we will continue to monitor it very closely, because it is a significant issue.

Mark Carney: Two points, if I may: first, I concur with what has been said. The problem with these funds is that the returns on their non-risk-free assets, particularly on equities but also on corporate bonds, have lagged behind the fall in interest rates. It has been the underperformance of equities relative to the performance of bonds. In some cases, it is that and insufficient contributions, but mainly that dynamic, which is an extremely unusual circumstance. We can get into that in more detail but it is not something that has been the case for 150 years. It is something that began in the middle of the last decade.

The second thing is this is an issue and you are absolutely right to raise it. It is a particular issue for some companies and some very large companies. We look at it from a macroeconomic economic perspective



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and we note the following: first, that the level of contributions to these funds has been broadly flat for the last decade, at around £9 billion per quarter; secondly, for a going concern company, there is a smoothing process to make up a deficit so that you do not get a sharp adjustment in the level of contributions, which could impair employment and capital expenditure. That is why that smooth adjustment is there. It is also there because sometimes you get things like the 10-year gilt yield goes from 140 in mid-June to 60 to 140 at the start of this session today. That which opened up the deficit or increased it largely goes away, although I would not say it totally goes away.

The other thing we do from an economic perspective is we assess the proportion of companies that will have to change behaviour because of an increase in deficit. We did an agent survey. It is reported in the inflation report.

Helen Goodman: I noticed that.

Mark Carney: 5% of companies say they may have to adjust investment plans, and these are companies with pension deficits. The YouGov survey came out earlier this week and was widely reported. If you go through the data and look at all respondents, 4% of all respondents say they may have to change investment plans. More than half the respondents say, "This is not applicable to me," the point being that this is an issue and we are monitoring it, but it is important to have some perspective and dimension on it. By no way, shape or form, in our judgment, is it reducing the effectiveness of the stimulus package that we put in place.

Q89 Helen Goodman: One of the problems people might have is they will have seen reports that the Bank of England can afford to increase the pension contributions that it makes for its employees to 54% of salary, so they may feel you are very good at promoting policies that impact on lots of people around the economy but actually you are not seeing it through and facing the problems in the same way that everybody else does, because you are in the fortunate position of being able to afford to increase your contributions in that way.

Mark Carney: You have raised a bigger issue.

Chair: A big question but a brief reply. I have four more colleagues who want to come in.

Mark Carney: The core of the question is you should look at the growth of total compensation because pension contribution is part of total compensation. Total compensation at the Bank of England for the last five years has been level pegging with the public sector, so we make a choice: what goes into pension contribution versus what goes into salary. As a consequence of that, salaries have grown more modestly, and that is the choice that is made by the Court of the Bank in setting remuneration.

Q90 Chris Philp: Mr Saunders, I think you came to see us a few weeks ago



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when you were being confirmed and you commented that some level of inflation could be looked through if it was caused by, for example, a movement in currency, as the Governor said earlier, and the most recent inflation report reflects that. It also says on its second page that there are limits to the extent to which above-target inflation can be tolerated. What is your level of tolerance?

Michael Saunders: I would not say there is a single limit. To me, it is a combination of the rate of inflation, how much slack we have in the economy, how fast the economy is growing, what is happening to domestic costs, and what is happening to inflation expectations. You can imagine that as those different parameters move around, the tolerance for above-target inflation shifts accordingly. Obviously if we thought we were in a position in which inflation was going to rise above target, and stay above target for a really extended period, that is not something we would be happy with. The tolerance for a period of above-target inflation is not because we are going soft on the inflation target.

Q91 **Chris Philp:** The current forecast is that it will be up to 2.8% for a good couple of years. That is within your zone of tolerance. The National Institute of Economic and Social Research recently forecast inflation could go to 4%, clearly higher than the Bank's forecast. Would you consider that a 4% inflation rate—they forecast that in the second half of 2017—would be outside your level of tolerance, if that came to pass?

Michael Saunders: It would depend what else is going on. If the economy is very weak, or if inflation expectations are falling and pay growth is low, those would all be factors that we have to take into account. The remit requires us to consider the trade-offs, and so we have to take into account a range of things. It would never be just the headline inflation rate.

Q92 **Chris Philp:** So you could conceive of a situation where you might tolerate a 4% headline inflation rate, if those other circumstances were propitious.

Michael Saunders: It is possible that we might. It is also possible that we might not.

Q93 **Chris Philp:** The Governor has been inducting you well into the art of obfuscating. Mr McCafferty, when you prepared the inflation forecasts here, what view did you take, if any, on the Government's alteration in their fiscal position? I think when the MPC met most recently, it was after the Chancellor said that we would no longer reach a fiscal break-even by 2019-20. That was a change of information from the Government that you had in your possession when you did your most recent report. Did you take that into account in your forecasts and in your most recent decision?

Ian McCafferty: We run on the basis of a convention on fiscal policy, which is essentially to use published information. As a result, we are still working on the basis of the published information provided at the last



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Budget and by the OBR. Once we know what will happen in November, we will then incorporate that into our forecast.

Chris Philp: Notwithstanding the fact that the Chancellor had explicitly and publicly said the 2019-20 was—

Ian McCafferty: He had not said exactly how much, over what period, or any other detail of fiscal policy, which would leave it as a very incomplete change to any forecast.

Q94 **Chris Philp:** Directionally, the Chancellor has said there will be a fiscal loosening, the details of which, as you say, he will announce in a few weeks' time. What would you expect the impact of that fiscal loosening to be on the outlook for inflation?

Ian McCafferty: I cannot give you detail until I know what that fiscal loosening would be.

Chris Philp: Directionally?

Ian McCafferty: Other things being equal, you would expect a fiscal loosening to slightly increase GDP and possibly slightly increase inflation. However, it will depend on the components of that fiscal loosening.

Q95 **Chris Philp:** When you are given the details, when the OBR forecast is updated for the Autumn Statement, you will have that information when the MPC next meets. Would you expect to therefore react to that in some way from a monetary policy perspective, once you have the specifics?

Ian McCafferty: Again, it will depend hugely on exactly what the Chancellor has to say, and our ability to incorporate it. I suspect we would want to incorporate it into a full formal forecast as a way of seeing the impact on the economy in the round, rather than necessarily reacting immediately. It will depend hugely on exactly how much he does, over what period, and exactly what the individual measures are.

Chris Philp: Governor, let me come to you. I do not want to leave you out. In August you announced quite a material monetary stimulus, a £60 billion expansion in the quantitative easing programme, with £10 billion of corporate bond purchases, a quarter-point reduction in the base rate, with forward guidance—subsequently discarded, but forward guidance at the time—that the direction of travel could be downwards. Despite that material monetary easing, five-year interest rate swaps, which were 50 basis points in August, have gone out to about 100 basis points, or 98 basis points, recently. Does that mean that your ability to influence the interest rates that are being charged in the market has been weakened or possibly even broken? The market has gone in the opposite direction to the one in which you wanted it to go.

Mark Carney: Can I just say one word on fiscal policy, just for clarity?

Chris Philp: Of course; we would be delighted to hear it.



Mark Carney: I would distinguish between an increase in the fiscal deficit and a “fiscal loosening”. What matters is what happens to the structural fiscal deficit. Implicit in, or actually effectively in a forecast, is the use of automatic stabilisers so that those will come through. If the economy is slower, if nominal GDP is slower, the fiscal deficit will increase. That is not a fiscal impulse; it is a fiscal tightening if that is leaned against. There is then a question of whether there is discretionary fiscal policy above and beyond that, all of which I am sure the Chancellor will explain.

First, on the package, the forward guidance was not discarded. The forward guidance operated as it should; it went away as the economy performed better. That is exactly what is supposed to happen. Part of the economy performing better is consistent with the rise in interest rates, and partly because there was not going to be another rate cut, but also because of an increase in inflation compensation or inflation expectations. Most of that move up in interest rates, at least in the initial period, was due to an increase in inflation expectations.

When we put the package in place in August, one of our concerns was that they were relatively low, so leaning against that was positive. There was an acceleration in the move in inflation expectations in early October, and partly because of that we are monitoring that closely, as we have said in this report.

Q96 **Chris Philp:** Is part of the upward move in inflation expectations a consequence of the relatively benign view the Bank has taken of the inflation, saying that it is prepared to tolerate a period of above-target inflation?

Mark Carney: The five-year/five-year inflation compensation went down on the announcement of this decision and associated communications around that. It went up for other reasons.

Chris Philp: It went up for other reasons.

Mark Carney: Yes.

Q97 **Chris Philp:** What do you think those other reasons were?

Mark Carney: Partly it is some improvement in the outlook, some mean reversion of going back to historic averages. Remember, they have gone back to historic averages, and I will remind everyone that inflation compensation is measured on the RPI, not CPI, so there is not a perfect mapping because of the nature of the instruments that are in the market in the UK.

One of the questions is to what extent there was some additional move because of questions around the Monetary Policy Framework, questions that I believe should have been put to bed by now.

Q98 **Chris Philp:** Moving on to the question of UK Government gilts, you



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have already mentioned that they have gone from around 50 basis points over the summer; 10-year gilts are up to, as you say, 100, 120 or 140 basis points now. This particularly happened in the period of September, October and the first half of November. Mr Saunders, why do you think Government 10-year gilt yields, which are normally quite a stable asset class, have gone up so quickly in the course of 10 weeks or so?

Michael Saunders: Part of this was due to changed perceptions of the UK economic outlook. In the immediate aftermath of the Brexit vote, people were probably overly gloomy—not just us, but the market in general—and then as the economy did better, expectations for interest rates naturally adjusted. There is a lot of it also that is a global trend. A lot of the down trend in yields in the UK in the last 10 years is not a UK story; it is a global story. In the last week and a bit, you have had expectations that US fiscal policy might be looser, and that has probably spilled over into higher yields globally.

Q99 **Chris Philp:** That is true, and I will come on to that in a minute. A lot of that move from 50 basis points to over 100—in fact most of the move—took place prior to the American election. Do you suppose some of that move was a response to signals that UK discretionary fiscal policy will be loosened?

Michael Saunders: That may be a factor, but I do not know that we yet know anything for certain about fiscal policy. I think the change in perceptions on the UK, and people moving away from recession or close to recession as their base case, has been the overwhelming factor.

Q100 **Chris Philp:** Do you think that, while the short-term prognosis is clearly more positive than we all thought it would be post-Brexit, the medium to long-term prognosis—by which I mean two to 10 years—will also beat expectations, or do you think that is impossible to say at this point?

Michael Saunders: I do not think you can say. I would caution you against trying to read whether the upside surprise in the near term tells us anything very much at all about the long-run prospects for the economy.

Chris Philp: That was rather the basis of my question.

Michael Saunders: As you know, I have been slightly more optimistic. I talked a few weeks ago about the near-term prospects for the economy. That is because of the support from relatively loose financial conditions. It is not a difference of judgment about the long-run effects of Brexit.

Q101 **Chris Philp:** We talked a little bit a few moments ago about the current account deficit. Governor, you specifically made reference to your view, and as you know, I have raised the current account deficit more than once in these meetings. You referred to the sustainable level of the current account deficit. Do you think that 6% is a sustainable level?



Mark Carney: It is unlikely to be but these things can move quite slowly. I would remind you that the sustainable level is a product of the external balance sheet of a country, as well as its relative competitive position, the degree of access to other markets and also the quality of the external balance sheet. The UK has a very high quality external balance sheet. All our liabilities are effectively in sterling, and our assets historically have returned much more than an equal amount of liabilities. On a mark-to-market basis, I am quite confident that the UK is still a net foreign asset holder, which puts it in a position to have a higher sustainable current account deficit, all things being equal.

For a large, advanced economy, however, a 6% current account deficit is very large, and historically when economies have started to approach that level, even the United States, there has been a downward adjustment in the current account. In the report, we provide our estimate, all things being equal, that given the scale of the exchange rate move and the level of domestic demand that we expect, we see the potential for the current account deficit to almost halve over the course of the next three years, to reach about 3% or 3.5% of GDP.

Q102 **Chris Philp:** Do you expect that to come from the trade balance, or from the primary income component as dividends and returns that are repatriated here in sterling effectively go up in sterling terms?

Mark Carney: Yes; the answer is both, and you are right to flag both, because the balance associated with the primary income for the net international position that has been one of the principal causes of the deterioration of the current account in the last few years. Grossly simplifying, but directionally accurate: lower returns from foreign investments, including in the European Union, has meant that deterioration. Now, with the adjustment in the currency, we should see a shift in that.

We do see an improvement in the trade balance. As we talk about in the report, there may be some frictions on the extent of that improvement relative to history, given some uncertainties about future trading relationships. Again, if there is a possibility of less open access in certain sectors, we know from both logic and from conversations with those businesses that they are less likely to add capacity to take advantage of that until they have certainty. That clips off a bit of the upside, but it is pretty modest in the grand scheme of things, in terms of the forecast.

Q103 **Chris Philp:** What is your timeframe for that halving of the 6% to 3%?

Mark Carney: By 2019, the end of the forecast. We should start to see a shift in it.

Q104 **Chris Philp:** Mr Saunders, you worked for Citibank until very recently, a major global bank, one of the many that will be considering what it does with its UK operations as we leave the European Union. What would you say to the Government about the timing of giving further guidance to the



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City, but to business in general, in order that we minimise the risk of businesses like Citibank and others, as the Governor said earlier, implementing plans to relocate certain parts of their business activity? What sort of timeframe do you think the Government need to work to?

Michael Saunders: I would hesitate to give them advice on that. I think the Government will make their own mind up. We have plenty of responsibilities; I am not seeking to extend them. As to what my previous firm will do, I do not know. You will have to ask them.

Q105 **George Kerevan:** Mr Saunders, just to pick up on something you alluded to earlier, the outcome of the US elections has clearly caused markets to reconsider their estimated future inflation. That has come slightly after the work done for this report. I just wondered whether you could make some comments on how that shifting global interpretation of inflation and the inflation environment might affect the UK.

Michael Saunders: I am not sure if markets are treating the US election as a higher inflation story, or a higher real yield story, maybe it is a bit of both. There may be a growth story as well, and that might spill over to the UK through a variety of channels. It might on one side have slightly higher gilt yields, as we have seen. By themselves, that tightens monetary conditions slightly, but at the same time the pound is a little bit weaker. If fiscal policy externally is looser, then global growth might be a little bit stronger, all else being equal, and we might gain from that. I am not sure what the net effect of all of that is on our growth outlook.

Q106 **George Kerevan:** But on prices?

Michael Saunders: Any inflation effect would follow chiefly from the growth effect, unless there is some spill-over from global growth to global commodity prices, which then affects us through import prices. I am not sure whether the net effect of all of that for us on growth is positive or negative but it is something we will try to look at. It might be easier once we have a clearer view on exactly what fiscal policy—

Q107 **George Kerevan:** You are resisting giving me an upside or a downside.

Michael Saunders: Yes, because there are a variety of channels at work here.

Q108 **George Kerevan:** Understood, but, for instance, the report forecasts a reasonably tight labour market through the period. If we have increased growth, will that not impact on wage demand?

Michael Saunders: All else being equal, I think that is something where there is probably a range of views among Committee members. As you know, this is something we talked about a few weeks ago. There is probably a bit more slack in the labour market here. I would not characterise the labour market here perhaps as being as tight as you implied it is. My own suspicion is that wage growth might be a little bit more contained.



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Q109 **George Kerevan:** Ms Shafik, we have, since June, a much looser monetary policy across a range of devices, but we have also loosened the fiscal buffers and created more headroom for bank lending. Given the prospect of inflation going above target, and given events in the United States, is the policy stance not too loose now?

Minouche Shafik: You saw the inflation numbers this morning, which underperformed what we expected—

Q110 **George Kerevan:** I never take a month's figures.

Minouche Shafik: That is very wise. We are not in a place where inflation is running rampant quite yet. I would say in terms of the current stance of policy that we know the economy is going to go through a period of adjustment, as withdrawal from the European Union occurs, and during that period of transition and adjustment, monetary policy can provide support to the economy. I do not feel the policy is too loose at the moment; I think the current stance is providing the kind of support that is needed now, but will probably continue to be needed going forward. I would say that.

Q111 **George Kerevan:** We have already used up half of the extra £60 billion that was made available for the next tranche of QE. Is that being held in reserve or is the plan to pay it out over a specific time period?

Minouche Shafik: No, the plan is to continue. The MPC voted to buy £60 billion of gilts; we have now purchased £30 billion. We also had a reinvestment of past stock of £12 billion, so we have purchased a total of £42 billion. The plan is to continue to buy the remaining £30 billion to meet the target set by the MPC of £60 billion over the next couple of months. We will probably complete that in January.

Q112 **George Kerevan:** It is a fixed programme; it is not a "wait and see"?

Minouche Shafik: No. The Committee voted on a stock, it was £375 billion, and they said, "We will add £60 billion", so when we get to £435 billion we will stop.

Q113 **George Kerevan:** So between now and January you will raise the spend to meet the limit of the stock, plus, presumably, as debt has been retired you are using the headroom that you had previously and spending that as well.

Minouche Shafik: That is exactly right, and so we will continue to reinvest and maintain that total stock level. We will have another reinvestment to do in February, and we will announce then how we will handle that.

Q114 **George Kerevan:** You are comfortable, despite events in the United States and despite the fact that you are forecasting over the review period, that the inflation target will go over the 2%. There is no change of view.



Minouche Shafik: In terms of the current forecast? No. Frankly, I do not think we know enough about the stance of policy in the US in the future to change the forecast. By the time we have our next forecast round, which will be in January or February, hopefully we will know more.

Q115 **George Kerevan:** I am sympathetic, but it always seems to me that if we wait for events, rather than anticipate them, we are always lagging, and then you get questions from us when you come next time.

Minouche Shafik: If we had perfect foresight we would not need forecasts.

Q116 **George Kerevan:** Governor, my reading is—and you can correct me—that given that you were prepared to tolerate going over inflation target, and the central forecast is trending towards 3% but, given uncertainties, the wider bands are taking us up to 5% within three years on the CPI, you are suggesting that the MPC's real policy target is to prioritise growth and employment stability rather than inflation. Is that right?

Mark Carney: No; no, I am not. Under the remit that we have, we have to take into account the impact of the trade-off between returning inflation to target and creating any "undo" for excessive volatility on output and employment. Translate that into lower output and higher unemployment, particularly in exceptional circumstances. A 20% move in the currency is exceptional. It is not unprecedented, but it is exceptional. A 20% move in a currency that is driven largely by market perceptions of a change in fundamentals is also an exceptional circumstance. It is not something that just happened; it is not exogenous; it is a view.

The consequence of that change, as you know, is a change in our real purchasing power. The question is: how is that best transmitted into the economy to balance economic outcomes and meet our remit? We had two choices, broad-brush. One is to take some of that in inflation, and maintain employment and output higher than it otherwise would be during a period of uncertainty and adjustment. During that period, is it better to have more people in work and the economy growing, all things being equal, given all the other factors that could be flying around during negotiations? Personal judgment: yes, all things being equal, subject to limits.

Or we have the option to tighten policy, to squeeze out that inflation overshoot, and effect the adjustment in real incomes that will inevitably happen, which has to happen, through lower wages and higher unemployment. That is the trade-off we have looked at. There are limits to that and our ability to see through that. At the moment the Committee judges that the stance of policy is appropriate, and that this overshoot can be tolerated, but it is a question of tolerating it as opposed to necessarily welcoming it.

Q117 **George Kerevan:** My liberal, left-wing soul actually agrees with that



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policy stance, but where I am going technically is that if the balance of judgment on the Monetary Policy Committee is always between the negative impact of moving from where we are now to dealing with a potential rise in inflation, it seems to me you can always end up in a situation where you are favouring the broader growth and employment. Is the existing policy goal, the existing monetary target, in itself sufficient? Should the remit that the next Governor has be broader, as with the Federal Reserve?

Mark Carney: No, I think the way the remit is constructed allows appropriate flexibility to do exactly what we have just done and what we are doing. It is coupled with the requirement to very clearly explain what we are doing and why, and to be challenged. I do not think we need a dual mandate as the Fed has, and potentially get ourselves in a position where we provide equal weight between inflation and employment. In most states of the world, the inflation target will dominate, and the best strategy objective for the MPC will be to return inflation as promptly to target as appropriate, so something in that 18 to 24-month time horizon.

I think the way the remit is constructed works quite effectively. I think this is right, but one of the consequences is that there is a point at which an overshoot would mean that the appropriate stance of policy would be to tighten policy, just as we indicate. The risks are two-sided; we have a neutral bias to tighten policy, even as it would mean a slowing in the economy with consequences for employment. There is only so much monetary policy can do in the face of very large real shocks.

Q118 **George Kerevan:** Given we are seven or eight years into not just a UK but a global policy stance of very loose monetary policy, the worry is constantly, "How do we move beyond that?" We are constantly putting that off. My next question is, if you put our loose monetary stance in the global context, we have a quarter of global sovereign debt being traded at negative interest rates.

Mark Carney: Probably more.

Q119 **George Kerevan:** Probably more. Have we not actually therefore created a gigantic misalignment of asset prices and effectively a bubble in sovereign debt? All we are doing with a series of short-term decisions on inflation is putting off a greater reckoning.

Mark Carney: A couple of things, first on semantics but it is hugely important: monetary policy is not "loose". Monetary policy is accommodating. The stance of monetary policy in terms of levels of interest rates, degree of quantitative easing, forward guidance and other mechanisms is exceptional. It is exceptional, it is unusual, but we are living in exceptional circumstances. If monetary policy were loose, we would not be debating 0.1s on the CPI inflation in the UK after almost nine years of having the Bank rate at its lowest possible level during that period of time.



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This is a crucial point, because it gets to the bigger forces that we talk about in this report, and which colleagues have talked about in other speeches. There is lots of Bank research and other research on this. The level of equilibrium interest rates in the global economy is very, very low. What matters is where policy and overall financial conditions are relative to those levels of equilibrium interest rates. The ultimate challenge is how to get growth up, but the immediate challenge is how to get those equilibrium rates up. That is not going to happen because of the stance of monetary policy.

We could be stuck in this trap—and I use that word advisedly—for decades. We are coming to the end of the first decade, and it could continue if we do not see major structural reforms, coupled with the ultimate pass-through of broader demographic and other forces, which are pressing down. Those demographic forces that are pressing down on these equilibrium rates will pass with time. The exceptional level of monetary policy is not the cause of this; it is a symptom of the situation. The causes are much more fundamental; the solutions are much more fundamental. Curing the patient requires the operation. Monetary policy is keeping the patient alive.

Q120 George Kerevan: Mr McCafferty, you had reservations about the final tranche of quantitative easing this year. Have you changed your mind?

Ian McCafferty: No. The reason that I voted against the immediate introduction of an increase in asset purchases back in August was a combination of belief that the economy was perhaps not going to slow quite as dramatically as some of my colleagues and our forecast were suggesting, plus a belief that as a result we had a little time to wait for further information. We were operating in August on the basis of only limited information. That information was very negative, particularly the survey information at the time, but my experience of running surveys over the years does suggest that in exceptional circumstances and with exceptional shocks, those surveys perhaps provide slightly less of a good indicator than they would do in normal times.

The correlation between business surveys and GDP is normally relatively good, but at times of major shock—I am reminded of 9/11, for example, when I was running surveys on behalf of the CBI—they do for a time perhaps provide a distorted outlook. I felt we had time to wait. I continue to support the completion of the quantitative easing expansion that is underway, on the basis that I think there would be serious consequences and serious costs to the economy were we to stop it halfway though. From that point of view, while had there been a proposition on the MPC to increase quantitative easing as of last month in isolation, I would have voted against it, having undertaken the process, those costs are sufficient that we should continue with the programme already underway.

Those costs are essentially twofold. One is that clearly we have seen bond yields start to rise quite dramatically as a result of other



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uncertainties in the world economy, and I would not want to exacerbate the volatility in the economy. The second is that, as Dr Shafik was talking about, we have undertaken to provide a quantity of quantitative easing. Were we to stop that in the middle, I think some of the impact of that policy would be compromised for future activities. There would be a cost in terms of the efficiency of quantitative easing, were we ever to need to deploy it in the future.

Q121 Chair: That is a full reply, and very interesting particularly on the surveys—that they are no use when you most need them.

Ian McCafferty: I would not say “no use”, Chairman, I would say that you have to be very careful in interpreting some of the short-term data.

Mr Rees-Mogg: Good morning. May I first of all thank you, Governor, for inviting me to the Bank of England Christmas party. I think it is very gracious, so thank you very much.

Mark Carney: Everyone who is in this room is invited to the Bank of England Christmas Party.

Chair: Can I take it that is an invitation to the whole Committee?

Mark Carney: It was supposed to be an invitation to the whole Committee

Q122 Mr Rees-Mogg: To get back to one of the things you said earlier, Governor, on what happened in August and the beneficial effects of indicating that monetary policy would be eased further later in the year, and that that had a helpful effect economically. I think that is quite important, because does it follow from that that the forecast made by the Bank of England will have an effect on economic activity, because they will have a similar effect on sentiment?

Mark Carney: First, my comments earlier referred to the financial market implications of that guidance, which did show up in the financial markets. One of the reasons why there was a bigger pound-for-pound impact of the announcement, if you will. You are right in that that should then flow through to economic activity, although normally with a lag. I would suggest that in terms of the effect on the high street with businesses, the effect would have been the package as a whole, as opposed to any specific details around the package.

The last point I would make is that I think when we make a decision, the direction has an impact in terms of sentiment, the details less so. An adjustment to our forecast I would not expect to have, per se, as big an impact as an actual policy decision. It would have to be pretty substantial.

Q123 Mr Rees-Mogg: This was more the intention of a policy decision rather than an actual policy decision.

Mark Carney: That is what I mean. That intention of the decision shows up in financial markets, which can digest it, and it would get



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largely lost on the high street, if I can use that term. The fact of an easing of policy was clear to everyone in the country, and certainly became clear as SPRs and other rates came down very quickly.

Q124 **Mr Rees-Mogg:** But you would expect it to be transmitted through the financial sector through to the high street, with a lag.

Mark Carney: With a lag, and if I could just finish, as it turns out that lagged effect of the potential future reduction in rates, by the time the lag starts to take effect, the forecast is revised and it falls away.

Mr Rees-Mogg: It ceases to be necessary.

Mark Carney: Exactly.

Q125 **Mr Rees-Mogg:** Therefore, does the same apply with forecasts more generally? They do not have a direct impact on the high street, but they have an effect on financial analysts and financial markets, and that feeds through to the real economy with a suitable lag?

Mark Carney: Yes, I think that is right. As you can appreciate, it is a fuzzier transmission mechanism than actually changing the price of money, and of course the effect is largely in terms of what we are likely to do in terms of stance and policy, and anticipation in the financial markets.

Q126 **Mr Rees-Mogg:** This, therefore, makes your economic forecasts more important than anybody else's because, other than perhaps the OBR, they are the most authoritative forecasts available in the marketplace. They have a direct influence on monetary policy, whereas the OBR has direct impact on fiscal policy, and that puts the two very much at the top of the pile in terms of prestige and influence.

Mark Carney: Certainly in terms of influence at the MPC, yes.

Q127 **Mr Rees-Mogg:** Therefore, when they are wrong and are revised quite sharply, that is something of a problem.

Mark Carney: Forecasts are always going to be revised. It will be a rare forecast—in fact I cannot think of one—where events transpired exactly as forecast. The question is whether the underlying economics are consistent, and what is learned from that process. In the event, what transpired is a consequence of welcome near-term strength in the economy. What transpired in terms of consequences, as you know, is that we did not cut base rate again, and by providing guidance in advance, the market got the contingency there and pulled it out consistent with a correct interpretation of our reaction function, if I could use that term.

Q128 **Mr Rees-Mogg:** But with the forecast that came out in August, it is hard to spot which bit of the forecast was right, and this is quite difficult in terms of the position the Bank is then in, in guiding policy.



Mark Carney: No, I do not think so. The first thing is that certainly from the view of the MPC—not just my view, but the view of all the other eight members of the MPC—is that the policy decision taken in August is still appropriate in November. One of the reasons for that is the underlying economics of the forecast are there. Let me explain briefly, and then you can drill down. In terms of response of business to this uncertainty in the future relationship, we are seeing that. Business investment has been soft; it has just been a little less soft than we had expected. It has been soft, and on a range of indicators the quality of the real-time investment statistics, as you know, is not great.

In terms of the reaction of households, consumption has been stronger, consistent with more adaptive expectations to circumstances. That is the reason for the upward revision. The degree of uncertainty in the very short term has been a bit lower, and financial conditions have been a bit better. I would argue that for both of those, that is not entirely unrelated to what we did in August. There is a recursive element to this: if you succeed, you end up with a better circumstance on the margin—I am not saying it is the only reason, but on the margin—and that is welcome. It is welcome that the economy will be at a higher level by the end of the year than we had thought in August.

Q129 **Mr Rees-Mogg:** So you do not at this point wish that you had listened to Mr McCafferty more carefully in August, and followed his advice.

Mark Carney: I listened to Mr McCafferty; we all listened very carefully. The MPC forecast is a consensus forecast; it is not my forecast, nor Mr McCafferty's, nor Dr Shafik's—certainly not Mr Saunders', because he was not there. It is a consensus that comes together, and that was our best judgment. We did signal two things: first, exactly Mr McCafferty's point, which is that at these times of big shifts and uncertainty, aim off the surveys. In hindsight we did not aim off enough on the surveys in terms of near-term momentum.

Secondly, we signalled that it is an unusually uncertain time, given events and the circumstances we find ourselves in, but in terms of the overall reaction of the economy, this is more of a slow-motion slow-down than a sharp adjustment. Relative reactions of businesses and households are still consistent with what we thought in August.

Q130 **Mr Rees-Mogg:** So in terms of how you try to make your forecasts more accurate in future, would this relate mostly to your evaluation of surveys, or are there other things that the Bank is putting in place? I suppose I am getting at the question of the extent to which it was group-think in August: everyone thought it was very bad, and therefore, they had a little bit of evidence to say it was bad, and they all looked at that and then made the forecasts that they did? I accept your point that all forecasts are always wrong, but this was perhaps even more wrong than usual.



Mark Carney: Firstly, the first thing in terms of orders of magnitude of revision, the revision we put in place for 2017 is smaller than the revision we put in place when I first came to the Bank in 2013, a revision when we put in place a forward guidance. We upward-revised growth for the year ahead by a bigger number, just under 1% at that time. That is first in the order of magnitude. The second thing is to distinguish how we construct a forecast like this. Our forecast for growth three months ahead, and even six months ahead, is more of what is called a "nowcast". It is more based on the historic statistical relationships between things like the CIPS survey, the CBI surveys, etc, and the momentum in the economy.

Those are pretty good indicators. You have to be careful of the turning points, so you are right in terms of the caution for future MPCs: when you have a big turning point, be careful of over-interpreting those. I will make this point, which may be cold comfort to you, but we had a much higher growth expectation than virtually anyone else who was putting out a forecast at that time. We had been giving a signal, "No, we do not think the economy is going into recession; we think it is going to slow," and this uncertainty impact could hit the consumer as well as businesses. As it turns out it has not really affected consumer behaviour, and therefore has not affected the housing market as much as we thought.

The lesson learned is around the big turning point. That point is reinforced. We will always go through the decomposition in terms of these relationships, but the test of the forecast is as it turns into 2017 and how the economy evolves at that point. Do we see this further softening of business investment because of uncertainty, and does the consumer start to come off?

The only caveat to that is obviously the big difference between the August forecast and November is the other big move down in the exchange rate, which makes the drag on consumer real income in 2017 greater. That in itself has an effect, so it is possible we end up at the same result but for different reasons, and we would come clean on why it did, what we thought then and what transpired.

Q131 **Mr Rees-Mogg:** To what extent do you think the currency is influenced by the changes in monetary policy made in August and the indicated trend of monetary policy?

Mark Carney: Candidly, very little, unusually so. The currency markets move at different times, for different fundamentals. Sometimes the current account is very relevant, sometimes it is relative growth, sometimes it is the stance of monetary policy-associated inflation expectations, and sometimes it is all of those together. It is hard to discern. Sometimes it is political events. Right now, for some time sterling has been trading on expectations of future relationships. We delivered a package that was bigger than expectations, in August. The movement of gilt yields on the day was very modest. The movement on currency on the day was about *1%* [13.05.36].



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You will see in the report that sterling basically stabilises over that period subsequent to August, and then it moves around a bit but is broadly in a stable channel, and then the announcement on Article 50 timing, and sterling moves to a different level. The market may be wrong about the consequences of that; we are not making that judgment, but that is not a monetary policy driver.

Q132 **Mr Rees-Mogg:** It is general background. I think it is just with the expectation of higher rates in the US and continued low rates in the UK. You think that has not been an influential part of the overall, particularly dollar-sterling.

Mark Carney: What is interesting—and we can send the decomposition if there is interest—is that the news on interest rates between August and November was in favour of the UK. In other words, in the news and people looking at the guidance and the outcome of the forecasts in the economy, the market said, “Okay, UK rates are going to be higher than we otherwise had expected,” and by more so than their increased expectation of Fed tightening. So, all things being equal, sterling should have strengthened somewhat, particularly from the end of September to November, if the relative path of interest rates were the only thing driving the currency.

Of course that was reinforced by economic surprises. It did not strengthen, as you know; it went down over 6%. For the time being, monetary policy matters for the exchange rate, and for the avoidance of doubt we care about the exchange rate. We do not target it, but we care about the exchange rate. It has an important influence on inflation, and there are limits, etc. However, for the moment the relative stance of monetary policy is not heavily influencing the exchange rate. It is these bigger fundamental judgments that the market will make, and then revise, and then make again, and then revise again.

Q133 **Mr Baker:** Have you lost the plot, Mr McCafferty?

Ian McCafferty: No, I do not think so at all. I think we are reacting in a consistent fashion to significant changes in the information with which we were presented back in August. As I say, the data was suggesting that the immediate reaction to the referendum was for a sharp loss of business and consumer confidence and a sharp slowdown in prospect—at least, as I say, on the data that we had at that stage. We have learnt quite a lot since then in terms of how the reaction to that referendum is unfolding, and as a result we have changed our stance in response. By no means have we lost the plot; we are reacting in a very logical and consistent fashion to changes as they occur.

Q134 **Mr Baker:** I should say, since I am now also looking forward to your Christmas Party, that I was not seeking to be offensive. I was referring to an article by William Hague, who writes in the *Telegraph*, “I have come to the conclusion that central banks collectively have now indeed lost the plot”, after listing 10 points where he thinks there are serious drawbacks



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to current global monetary policy. I have listened very carefully to the reasons you have given for the stance of monetary policy, both to Jacob in relation to the interest rates and the effect on the exchange rate.

William Hague wrote, "The whole point of their independence was that they could be brave enough to make people confront reality. Yet in reality they are blowing up a bubble of make-believe money to avoid immediate pain, except for penalising the poor and the prudent." The point I particularly want to make to you, Governor, is this: you have explained with great clarity—I think it was to Mr Kerevan—that you have made a choice that you would rather have higher inflation and higher employment through a period of uncertainty than the alternative. You put that very clearly.

Would you accept that, therefore, the decisions the MPC is making now are profoundly political in their implications, and that is why we find the former Chancellor, the Prime Minister, the former Foreign Secretary and Leader of the Conservative Party making such statements about not only your own policy, but the policies of central bankers as a class?

Mark Carney: No, I would not accept that. What is crucial is that we follow our remit. Our remit directs us to make judgments about precisely this trade-off and explain it clearly. We made a judgment that this is better, given the nature of the shock. It matters why the exchange rate moved. If it were a crisis of confidence, an exogenous move in the exchange rate or related to monetary policy itself—there are questions around that—we would have an entirely different reaction function, certainly from me, and I suspect from the rest of the MPC. However, when it is driven by a real factor, and there is an adjustment that will come in one way or the other, then you get a reaction consistent with this, as directed by our remit.

I do not accept, and I am not speaking about the specific article to which you are referring, the line of thought that central banks should not focus on their remit, but should tighten policy in order to force Governments to take tough decisions. That is political. That is straying from the remit. No. We have to take fiscal policy, structural policy and the nature and potential messiness of negotiations with the European Union and other trade deals as given, and then we have to optimise around it.

Q135 **Mr Baker:** You have given a very clear answer. We do not have time to go through all 10 points from William Hague. In particular, I think you said the connection between monetary aggregates and inflation was non-existent; perhaps we could come back to on another occasion. William Hague makes the point as follows: "Pumping up the prices of stock markets and houses without an underlying improvement in economic performance becomes ever more difficult to unwind and ultimately threatens an almighty crash whenever it does come to an end—wiping out business and home buyers who got used to ultra-low rates for too long."

I have to say that I did not write this for William Hague. I like to think I



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could have done. Dr Shafik, is this not the risk that is now being run in holding rates so low for so long? For the record, I should say that you are nodding. Is this not the risk we are running now, that there could be an almighty crash when, in due course, it is necessary to unwind these policies? I would like to ask Dr Shafik, please.

Minouche Shafik: Sure. As to the reason rates are low, we do not choose the interest rate that the economy needs. The economy needs a low interest rate because the balance of savings and investment in the economy is such that low rates are needed. You can think through the hypothetical of what would happen if we raised rates prematurely, and what that would do to output and throwing firms into bankruptcy that could no longer afford to employ all the people they currently employed, even if they are dependent on low rates. Those are very big economic costs to pay at a time when inflation is well below target.

It is hard to find a good economic rationale for an alternative course of action at this juncture, given the state of where global interest rates are, and the massive adjustment that the UK economy has ahead of it. It would be—

Q136 **Mr Baker:** I know, Governor, you wanted to come in, but if I may, I would just like to put a couple of points to you and then perhaps come back to you once more, because I think we do need to get to the point of stopping. Obviously, I am only a mild-mannered aerospace and software engineer, so I took a bit of advice. I understand that Capital Economics' analysis is that Brexit meant markets assumed Bank of England interest rates rises would come later because of Brexit, so sterling was less attractive and that, therefore, produces the impact on the exchange rate. You have refuted that, but I just observe that there is a fundamental difference amongst economists on this point.

Mark Carney: I do not credit that

Q137 **Mr Baker:** You simply do not pay any regard to what Capital Economics are saying.

Mark Carney: I do, and I certainly look at them from time to time, but not on this point. I think this is about as clean a relationship as one sees in the foreign exchange market.

Q138 **Mr Baker:** I feel sure they will have a look at it. I hope they will. Dr Shafik, any errors or omissions are my own, but I asked Andrew Lilico about this point. He raised the issue of how quickly M4 has been growing, and he said I should focus on asking you whether it is justified to have interest rates at 0.25% when annual M4X growth is 7.7%—it is, of course, down a bit now—in the four quarters to quarter 3 of 2016, the fastest since the four quarters to 2008 quarter 1, significantly, with GDP growing at 2% annually and likely to grow at close to 2% next year, and unemployment at 5%. Are you not overstimulating the economy at this point? Are you not running the risk of giving us all those problems which William Hague has elaborated in his article? Please, Governor.



Mark Carney: Was that for me?

Mr Baker: By all means.

Mark Carney: No. The central expectation on inflation is as we have outlined in the report. Let me say one thing on the asset price side, if I may. In relative terms, given where global interest rates are, even with what has happened in the last few weeks and in fact even with a substantial continuation of that, the equity risk premium in equity markets, particularly the UK equity markets but equity markets more broadly, is near historic cost. The relative valuation, given where discount rates are, and given the broad neighbourhood of where the equilibrium interest rate would appear to be, is not that these markets are stretched. They will move with underlying economic fundamentals.

The second thing is the housing market. House prices in the UK are high because there is no supply, and the more we avoid this point, the more we pretend that the ills are the consequence of monetary policy. This is what I said earlier; there is a massive blame deflection exercise. We are going to do what we have to do, given the suite of all the other policies that are in place. That means we are going to have to do macroprudential policies to tighten borrowing in mortgages. It means that we are going to have to run exceptional monetary policy because there is not sufficient demand.

We are going to continually make clear that we cannot make the structural decisions that are going to change the path of productivity in this or any other economy, and therefore change the path of real interest rates. Others will make those decisions; you will make those decisions. While I fully accept that when we are here it is necessary and welcome, to go back to that, that we are challenged on our forecasts and on our policy stance, we should not confuse what drives fundamentals with monetary policy.

Monetary policy does not drive fundamentals. Monetary policy drives nominals. We can avoid some of these bigger issues if we pretend—I am not saying that you are pretending—and we have an endless dialogue about monetary policy instruments as if they are the ones that determine, for example, the level of equality in the economy. Those are driven by much bigger factors.

Q139 **Mr Baker:** We are very short of time, and we have really run over, but I would say that on housing I do think it is “both/and”. I made a point to a friend from the City about the extraordinary cost of his semi-detached house in Chiswick very recently, and he immediately accepted that it was because of easy money, and in particular, working in the City near its source. We really do not have time to bang to and fro about it. I certainly accept that we need to build houses, but from my point of view it is a both/and problem, particularly in relation to the distribution.

Q140 **Chair:** Ms Shafik seems to be agreeing.



Minouche Shafik: No.

Q141 **Chair:** You were nodding your head in agreement, but disagreeing?

Minouche Shafik: On supply.

Q142 **Mr Baker:** Perhaps we will return to it another time. The final point I want to just explore is this: is it the correct view that you should, as a Committee, be looking for reasons to raise rates, or should you be looking for any opportunity to start returning rates to levels that you would describe as ordinary, since you describe these levels as extraordinary. Should you not be taking every opportunity to gently raise rates back to normal levels?

Mark Carney: It would be absolutely welcome to raise interest rates. It would take some pressure off macroprudential policy, but we are only going to raise interest rates if that is consistent with our monetary policy remit. The sole exception, given the structure of the Bank of England, is if we felt between the two Committees, the MPC and the FPC, that macroprudential tools were insufficient to address material financial stability risk, and monetary policy, as the last line of defence, needed to be used. We would take those into account, consistent with the remit.

That would be a very transparent process, though, in terms of joint meetings and reporting into this Committee and to the public more broadly. Yes, conceptually we would welcome it, but consistent with the remit and consistent with the changes that are underway in this economy, at the moment the stance of policy in my judgment, and the judgment of my colleagues, is appropriate.

Q143 **Mr Baker:** An additional question, if I may—and I think I may—is this: have you given any thought to what the effect on the exchange rate would be if at this meeting you had chosen to reverse your previous policies? I heard what you said, Mr McCafferty, about the future efficiency of QE, but had you abandoned QE and returned base rate to 0.5%, what assessment have you made on the likely effect on the value of the currency? Perhaps Mr Saunders could start, and we could ask each member of the Committee what they think the effect on the currency would have been if you had returned to your prior policy, which was still quite extraordinary.

Michael Saunders: I do not know; I have not seen such an assessment. I assume that the pound would probably have gone up, and probably growth would have been weaker and unemployment would be higher. We might still have this inflation overshoot over the next couple of years, but remember, that inflation overshoot from the sterling's drop is temporary, and so under your alternative world we might then be facing an inflation undershoot further out. One thinks of the trade-offs; we would have higher unemployment near term, and an inflation undershoot further out. That is why I did not vote for that as an outcome.



Minouche Shafik: I would agree with Michael in that hypothetical sense, all other things being equal, but I have to say that we follow what happens with sterling very closely. The primary driver of sterling movements over the last few months has been expectations about the future trade relationship with the European Union. If you talk to people in the foreign exchange market, that has been the primary driver of movements in sterling and I think that has overshadowed what the interest rate is.

Q144 **Mr Baker:** Mr McCafferty, just so that we can leave the last word to the Governor?

Ian McCafferty: To try and keep it as brief as possible, I agree very much with what Minouche has just said, in the sense that sterling is being driven by some very big structural plate tectonic factors at the moment. I suspect that small changes in monetary policy, as the Governor has already indicated, in terms of reactions that we have seen since August, would have relatively small and probably very temporary effects against those backgrounds.

Mark Carney: Yes, I think that is right. I go back to what Mr Saunders says; it has to be a sustainable change in the stance of monetary policy, and if the consequence is to engineer a big undershoot of the target further out, which then requires an adjustment and subsequent reversal of that reversal, then it does not seem sustainable and it does not do a great deal of good for the credibility of the UK.

Q145 **Mr Baker:** Thank you very much; it has been a very interesting session.

Chair: Yes, we are all coming to your Christmas party. We are looking forward to it very much indeed and we might bring the odd staffer or two.

Mark Carney: I will lay on the eggnog.

Chair: Thank you very much indeed for this extended hearing. In fact it was two hearings, we had a lot of ground to cover and we have picked up quite a few things that I think will be of interest. Thank you very much indeed.