House of Commons

Treasury Committee

Oral evidence: Appointment of Jonathan Hall to the Financial Policy Committee, HC 621

Monday 20 July 2020

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Anthony Browne; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 19

Witness

I: Jonathan Hall, External Member, Financial Policy Committee, Bank of England.

HOUSE OF COMMONS

Examination of witnesses

Witness: Jonathan Hall.

Q1 **Chair:** Good afternoon and welcome to the Treasury Select Committee's appointment and reappointment hearings for Bank of England committees. I am very pleased to be joined first by Jonathan Hall, who has been appointed as an external member of the Financial Policy Committee. Could I begin, Jonathan, by asking you to briefly introduce yourself to the Committee?

Jonathan Hall: Hello, it's is nice to meet you all. My name is Jonathan Hall. I am the appointee to be external member of the FPC.

Q2 **Chair:** That's great. Thank you very much, and thank you for joining us. I just have one question. I noticed in your answer on your questionnaire, Jonathan, that in the areas where you felt you needed some further development you included cybersecurity, property and challenger banks but you did not mention insurance. Insurance, of course, will be very important to the remit of the FPC, and it is not an area where you have worked in the past, to my knowledge at least. I just wondered why insurance had not featured in your response there.

Jonathan Hall: That is a good question. In my work I did engage a little bit with pension funds and insurance, particularly with their liability hedging in the back end and longer-dated exposures. My experience there is a little bit higher than it is with the three that I listed, but you are absolutely right that there is a lot that I can do to learn in that area, and I look forward to doing that from other members of the committee and from the Bank. You are correct.

Q3 **Felicity Buchan:** My questions are on the effect of coronavirus on the economy. I noticed in your questionnaire, in response to the question, "What are the differences between the 2008 financial crisis and coronavirus?" that you did not allude to the difference in scale and also the Government's mitigation efforts. How do you think the Government's mitigation efforts with coronavirus compare with the response to the 2008 financial crisis?

Jonathan Hall: The most important point is that, globally and in the UK as well, Government responses and the responses of central banks have been huge and very rapid. They have made a very significant difference. As I said also, whereas in 2008 the banking system was a real amplifying factor of the crisis, in this case that has not been the case. The transmission mechanism from the Government actions and the central bank actions has been much more successful. Absolutely, the speed and the size of the actions, both here and across the world, have been very significant and hugely impactful. We can see the effects of that in terms of financial conditions, et cetera.

It is slightly helpful, in a way, that some of the tools that were prepared in the financial crisis, from a central bank perspective, were able to be used this time. That is one reason, perhaps, that we responded more quickly this time than in the previous crisis.

Q4 **Felicity Buchan:** Would you have done anything differently in the UK if you were seated in the Chancellor's chair, or indeed in the Bank of England's chair?

Jonathan Hall: That is a good question. I am definitely not going to be seated anywhere near the Chancellor's chair, so I do not think I will be able to answer on that. The Chancellor did say one thing early on that I agreed with. He said, "We should not let the perfect get in the way of the good". The speed of the response and the size of the response were necessary. It has been reported and discussed that there are gaps. With time, one can maybe address those.

With regards to the FPC, what is really important is that there has been some discussion of the countercyclical buffer and the increase in the countercyclical buffer that had happened previously. The Treasury Select Committee has been very aware of that. In terms of the speed and timing, that was released very early on to support the lending to the real economy. There were huge draws on banks. In the month of March there was 30 times as much credit drawn as in any month in the previous year. It was really important that there was this confidence to carry on lending and the countercyclical buffer was released.

It is important, as the FPC is still a relatively new committee, for the public, the financial press and politicians to see, both in good times and in bad, the actions of the committee. That was pretty important and helpful, even if—maybe we will discuss this later—it did not get quite as much press as perhaps it should have done. It did help the financial system.

Q5 **Felicity Buchan:** What more do you think the FPC can do to support the economy?

Jonathan Hall: That is a good question. It would be nice for me if they had left a little bit of the buffer so that I could now say we could release the rest, but they released the buffer down to zero. Another thing that has been important is the stress test. There was the rapid stress test based on the scenario from the MPC. That gave clarity to the banks and the markets more generally that, in the kind of shock that one could imagine was hitting as a response to the public health measures, banks were still in pretty good shape from a capital perspective. Banks should know that they are themselves in that position, but it is important for them to know that all the other banks are and therefore are able to support the economy, which is good for the economy but also good for them. That was another action. If we get more waves or shifts, that is something that the Bank could do.

As I am sure you are aware, the FPC has been meeting more regularly. It is very focused on what is going on. There are areas where the FPC can directly get involved, and there are other areas where perhaps we can be around the table in discussions and support other actions.

Q6 **Felicity Buchan:** What is your view on the OBR's scenario forecast? What do you think we can do to maximise the chances of the best-case scenario coming into play?

Jonathan Hall: That is a really big question. I will try to answer it. In the long term, what is really needed—this is important and it is very exciting for me to hopefully be involved in—is the second part of FPC's mandate, which is productive growth, boosting productivity, boosting real wages and, hopefully, reducing regional inequality as well. That is the long-term answer.

In the short term, the real risk is what they call economic scarring. It has been a long time; it has been four months that people are out of the workforce. Businesses are changing the way that they feel that they can carry on working. It relates a little bit to office space use as well. We have heard a lot about sandwich shops in cities. The longer this goes on, the more changes there are and the more that certain parts of the capital stock and certain parts of the employment market start to lose touch with the economy. That is a reason for everyone to move as fast as possible, to increase the speed of the recovery and to mean that this is more of a bridge to recovery rather than being a very slow recovery, where you do get more of the scarring effects.

Q7 **Julie Marson:** Hello, Jonathan, thank you very much for joining us. Over the past few months this Committee has heard many comparisons with 2008, and we have discussed that kind of comparison. We have also heard different views on the levels of corporate debt and whether people are concerned about that. In terms of your questionnaire, we talked about 2008 and you mentioned that the banks are better capitalised than they were then. It is fair to say that the Chancellor last week gave his view that actually, historically, corporate debt levels were relatively low. Equally, we have heard from organisations such as TheCityUK that there might be unsustainable corporate debt of about £100 billion, half of which could be to SMEs. In that context, could you give your view of the scale of corporate debt, whether it is sustainable or not and how much of a risk to financial stability that is?

Jonathan Hall: The good news is that, in the UK at least, the corporate debt levels going into the Covid shock were relatively low. Linked to that, bank exposures, both to corporates but also to property, for example, were relatively low; they were pretty low versus the previous crisis. On the way in, we were in a relatively good place. That is a reason why, despite this being a huge issue, especially in terms of public health and an incredible, very steep slowdown in GDP, so far we have not seen the systemic issues that you highlight.

TheCityUK is talking about this new debt. If we wanted to summarise the response to the crisis in one word, it has been a bridge. It has been a bridge across this very fast slowdown. The problem with that is that, for some companies, maybe their purchases have been delayed; they will get that money back and the bridge is all they needed. For many others, there will be a period of lost revenue. It is then, really, not debt that they need, but more like equity. That is what TheCityUK was starting to talk about.

Of course, some companies have done quite well through this. There are some companies that will be really good going forward, but have lost this hole of the last four months. There are others that were struggling beforehand, and they are obviously going to be in trouble given that. It is that central part where really good companies, through no fault of their own, have been hit and are not going to get that money back. That is what TheCityUK was talking about. It is a really important topic. It is not an easy one. I do not know whether it is part of my mandate to be involved, but I hope I can help in any way I can.

Q8 **Julie Marson:** How would you think that the FPC could help?

Jonathan Hall: The FPC's mandate is financial stability, and so really I imagine it is more on an advisory basis. It is not obvious to me the policy tools that we would make. If there is a financial stability risk from this, it will come via a further slowdown, so monetary policy will be the first response. As I responded to the question earlier, the Government will have a part to play. Hopefully, private institutions will also be able to help. It is the beginning of the debate. I hope I can help. I am not sure that the FPC has a specific tool that will solve this.

Q9 **Julie Marson:** It is interesting, is it not? The Chancellor was fairly non-committal in terms of how he saw maybe a Government response in terms of equity provision to mitigate the debt. Do you have a view on the role of Government in that?

Jonathan Hall: The only thing I would say is, if you look at traditional private equity or venture capital, the returns that they need for investment are relatively high. You can imagine a scenario where there are externalities that are really positive for the economy, which mean that this is a really good thing to do, even if you generate returns that are significantly lower than the private market would normally expect. In that situation, which is probably the case, you can imagine that there needs to be some kind of working between the Government and the private sector. Under that assumption, which I think is fair, that is why at the moment there is this cross-public and private sector discussion. I do not know how it will end up.

Q10 **Chair:** Before I go to Steve, can I just press you a bit on that, Jonathan? When the Chancellor appeared before us and was asked about small and medium-sized enterprises and debt, he said something along the lines of, "The Government cannot step in and start taking equity positions in lots of small companies", which of course is true. Can I just press you on that? What sort of things should the Government be looking at? What kind of structures might there be to get assistance into those small and medium-sized businesses?

Jonathan Hall: Interestingly, there is the longer-term perspective here, which is about boosting productivity in the UK, and that leads back to the Patient Capital Review and the fact that there are these pools of money. You mentioned insurance companies earlier, as well as pension funds. They do have long-term liabilities. They should be patient and so they should be looking for an opportunity to generate returns from diversified businesses over the long term, but the current market structure is such that they do not really have access to that.

This is part of a broader review, which is relevant to the FPC. The question is, are there changes that the FPC can make? Are there changes to the financial market structure that would support this and support patient capital coming in and boosting investment, which then boosts productivity and real wages? Is there something in that work that you can really accelerate and apply to this situation right now, which is not that dissimilar? I do not know the answer, and obviously there is nothing on the shelf at the moment that you would just take off.

Q11 **Chair:** What ideas would you have specifically on that, though? If I was asking you for your advice now on the committee, what would you be saying in terms of specific ways forward?

Jonathan Hall: You can imagine some kind of closed-end fund that has a very diversified pool of small and medium-sized businesses, potentially managed by people who have experience in this space. It is very difficult for an insurance company to invest in a single SME company, but a portfolio of companies like that, managed by someone who knew what they were doing, is the kind of structure you can imagine being helpful. That is private, so then the question is whether the public sector needs to do anything to help that along, especially given that this needs to move faster than otherwise was expected.

Q12 **Mr Baker:** I refer to my registered shareholding in Glint Pay. I am very interested that you have studied for an MSc in epistemology, ethics and mind. You are doing a PhD in philosophy. Your original degree is in physics and philosophy. There is a particular knowledge problem going on at the moment. In December of last year, the FPC was not looking at pandemic risk; of course, it is now. This is fundamentally a knowledge problem. How do you think the FPC should be going about identifying major risks as we go forward?

Jonathan Hall: I am very interested in that area of policy. I hope that some of decision theory or some of the stuff I have been thinking of in that is going to be relevant to my role at the FPC. I certainly expect it to be and I hope it will be. The most important thing here, and I said this on my questionnaire—I hope it did not appear flippant—is about what the major risks are: one of the major risks is one that I am not going to have written on there; it is one that we have not thought of.

When you are building resilience in the financial markets, you are building it not only for the known unknowns, or the known risks, the black swans of grey elephants or whatever you want to call it, but you are also building for something that you are not expecting. The truth is that everyone was expecting a pandemic at some point. It was just that no one knew when it was going to hit. That should have been in the back of everyone's mind. Maybe it was in the back of everyone's mind; it just did not need to be written on every single piece of paper. Clearly, it was a risk. It was not a black swan. It is the kind of thing that general resilience is there to protect against.

To be fair, if it was over now, then you would say that the resilience that had been built up by the Bank of England since the crisis, including the countercyclical buffer, has so far done a good job for something that was a significant shock, out of the blue—expected, but with completely unexpected timing.

Q13 **Mr Baker:** Do you think we should be doing more to find indicators? It seems to me that some events are not very likely but potentially very severe. Perhaps this pandemic would be in that category. Should we be looking for additional indicators of what might turn out to be more likely than we expected? What indicators would you suggest for horizon-scanning with financial policy?

Jonathan Hall: Yes, absolutely. I hope that that is something that I can bring to the committee. It is certainly a focus of mine. You might want to call it a financial sentinel, or in the body some of your emotions pick up these things. It is the peripheral stuff. You have a central expectation, but it is the stuff at the periphery that you really need to be aware of. How do you do that? For example, the Bank's agents can help with that. There are people in the financial market; if you are listening closely enough, one of them will be screaming about the problem that no one else is thinking about for another three months. How do we get to that person? How do you extract the signal from the noise, because maybe that person has been crying wolf about that issue for 10 years, but this time, they might be right? It is very difficult, but it is super-important. As I said before, you also need to have this general resilience, just in case, because no matter what you do you are probably going to miss the thing that hits you.

Q14 **Mr Baker:** On that very specific point about the person who might have been crying wolf for 10 years, how will you seek to strain out the signal from the noise?

Jonathan Hall: A lot of it is not about finding the answer; it is about finding the right question. I talk about correlation, which may seem a bit nerdy, but if you notice relationships that normally hold suddenly flipping, then there is something going on there. Then you go away and you do your research. That is a question. There might be a really good answer. There might be something that happened that is unique to that scenario and it is irrelevant. Once you have done it, you set it aside.

The problem is that there is an almost infinite number of things you could look at. What you do is you scan the horizon, you find the things where there might be something and then you ask questions in that area. Hopefully, you take it from 1,000 to 25, you do your research and only five of them are actually real. The person was crying wolf or they were not; maybe this time they are right and other people have similar views. You then pile in in that area and build your focus. That is what I would like to do. How to build a structure that does that is tricky. I have at least three years to try.

Q15 **Mr Baker:** It has been quite a long time since the speech from Mark Carney, which I have referred to many times, in which he set out the arrangement we have today, where the MPC and the FPC have different remits but have an overlapping area of concern. Can I turn to a different knowledge problem? Do you approve of the monetary policy that has been operated recently, and in particular QE? At what point do you think that monetary policy might tip into concerns in financial policy? How do you actually obtain that information? How do you spot the moment where monetary policy is suddenly perhaps more relevant to financial policy?

Jonathan Hall: That is a really good question. Part of the answer is that it was a really important thing to think about when you were setting up the committee. This is a time when the structure of the committees is really important. The most important things, obviously, are a clear mandate, independence and scrutiny. If you have those, then once I start, from September, as long as I am focused on the role that I have been given—the role that you will also check whether I am doing correctly—then if it turns out that the MPC, which is also following its own mandate and acting in line with that, is doing something that, to me, looks inconsistent, then obviously there is a response there.

The CCyB was being built prior to the Covid shock while monetary policy was still very loose. Financial conditions were very loose. At that point there was this slight inconsistency between the two policies. When the Covid shock hit, suddenly everyone was doing the same thing: the Government, the FPC and the MPC were all trying to help the economy because it is in line with their own individual mandates. That is the important point. The structure is really key.

Mr Baker: Thank you very much. I am advised we are out of time, but I look forward to picking up these questions of the problems of knowledge in other sessions, hopefully.

Jonathan Hall: I would like that.

Q16 **Anthony Browne:** Thank you, Jonathan, for coming here. You were talking to Steve about how you identify the unknown unknowns. I am going to ask a slightly more prosaic question about the known unknowns. Of those things that you can identify, what do you see as the main risk to financial stability now?

Jonathan Hall: We have to talk about Brexit a little bit. On Brexit, there has been a huge amount of work done. For the FPC, obviously before my time and nothing to do with me, the checklist was super-important and very clear. We are almost there in terms of preparing the financial system for that. The one thing that is obviously concerning is that we are coming up to the date when, in terms of CCP, we will have to start thinking about whether it can continue to deal with European clients. That date is the end of September. If it has not been given equivalence or recognition by then, temporary or permanent, that is when you start to get fragmentation of the market. That is important. I hope and expect that equivalence or recognition will be given, in which case we are fine. That is an important point. It will cause fragmentation, it will cause inefficiency and there will be problems with regulation. It is not going to be disastrous for the economy, I think—I hope—but it is certainly one to focus on.

The other things that I am quite focused on with regards to the changes and potential scarring from Covid are things like commercial real estate. Retail was already on a downward trend. People were starting to think about different models for office space. I am quite interested in and have been focused for a while on the future of work and how automation will change things. For people with skills that are no longer needed, how do we retrain for that? My worry is that this change in working behaviour is going to accelerate that. As I mentioned, sometimes things can be good in the long term—maybe it will boost productivity—but if it happens very fast then that can be a shock.

The good news on that is that property exposures in the banks are much lower than they were before, so it does not seem like an immediate financial stability issue. Stress tests on commercial real estate are very harsh—much harsher than, for example, the OBR has just put in their recent forecast. We are probably okay, but it is something to watch. The MPC will be the first part in that, because that will be part of an economic slowdown. Those are the two that I will mention. The third is international risks, but I will stop there.

Q17 **Anthony Browne:** Can I just pick up on the Brexit point first? I should declare I used to run the British Bankers' Association, so I spent a lot of time doing those negotiations on financial regulation once we have left the EU. We have now left, but obviously it is after the transition period. Mark Carney made the point a few years back that actually, if we did not have control over our financial regulation in the UK, that would be a risk to financial stability in itself. That was a question about joining the single market. Do you agree with that?

Jonathan Hall: Yes. Most of it is in London, but the UK financial sector is very significant, it is complex, and it is quite different to some of the European financial sectors. It is very important that those that really care about it—the UK regulators—are the ones that are setting the rules. We cannot be a rule-taker from another jurisdiction. The question then is, for example on the CCP, whether you can have two regulators both regulating one entity. My experience with that is you have this dual problem of both overlap and tension but also underlap, because people are thinking that the other one has got it. You then have fragmentation of the regulatory system and things can be missed. It is very important that the UK remains a regulator for the financial market in the UK.

Q18 **Anthony Browne:** The Chancellor will be relieved to hear you say that. Can I ask you questions about the actual scope and role of the FPC? The FPC is obviously a fairly new organisation. In pretty much every discussion I have had with members of the FPC since it was founded, there has been a debate around what powers and what remit it should have. It occasionally gets new powers, like the countercyclical capital buffer that you mentioned, which is a relatively new power. Do you think the FPC needs any new powers? Would you be arguing for it to be given some other controls for it to be able to perform its remit?

Jonathan Hall: What is exciting about a new committee such as the FPC is that, just by the fact that it is established, a lot of work gets done. It is really driving forward research into the macroprudential. The kind of tools that are used have changed a little. There is the countercyclical buffer, as you mentioned. There were the stress tests on climate change and interesting, new kind of central banking.

The way we think about it is to ask, "How do we satisfy the mandate?" This is both the primary mandate and the secondary mandate of productive finance. We then look at the tools we have. If we think that we cannot satisfy the mandate without getting further tools, or if we just will not do as good a job with the tools we have, then we need to come back to you. At the moment they are moving along in parallel, but I certainly think it is possible that there will be a tool that will be very helpful in satisfying the mandate that you have set us and that we can come back to you in the future and ask for that.

Q19 **Anthony Browne:** So you are open to new powers in the future. Can I ask you about the capitalisation of the banking sector? You have made the observation, as have various other people, including Andrew Bailey, that because the banks entered this current crisis fairly well capitalised, they have been able to weather it reasonably well. Over recent years, the Financial Policy Committee has had a lot of internal debates about whether the banking sector needs more capital or not, and how high it should go and what the leverage ratio should be. Do you think the banking sector is fundamentally undercapitalised still, or do you think the arrangements we have now are about right? You have just released the countercyclical capital buffer, but what about outside that?

Jonathan Hall: Just to say clearly, you said I am open to new powers; I am certainly not asking for new powers and I do not want to reach beyond the mandate. I am not a power-grabber; I just want to satisfy the mandate.

In terms of the capital, I think it is so far, so good in terms of the way the banks have responded. As you know—it has been a bit of a mantra—capital is about three times what it was going into the crisis. Even with the stress tests, both the annual stress test and the desktop one, that is still significantly more than—more than double—what it was pre-crisis. That is good.

The only question is whether it is too much. Is it restraining credit supply or support to the real economy? There was not really any evidence that it was doing that. In the most recent situation you can see how particularly the countercyclical measures are able to really support and reduce the size of the downturn. This lack of amplification from the financial sector is hugely important. In terms of insurance, it was worth having that insurance.

The regulations are very complex. They are overlapping. If you change one regulation that is a binding constraint and move that back a little bit, you find another one is immediately the binding constraint. I do not know. We are in a much better position than we were before. The first of all of the major areas that we need to focus on have been done. It is very complex. I do not know if there is room to simplify. The answer is probably no, but I am open to further research in that.

Chair: Jonathan, thank you very much for appearing before us.