House of Commons

Treasury Committee

Oral evidence: Reappointment of Professor Silvana Tenreyro to the Monetary Policy Committee, HC 619

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 - 14

Witness

I: Professor Silvana Tenreyro, External Member, Monetary Policy Committee, Bank of England.

Examination of witness

Witness: Professor Silvana Tenreyro.

Q1 **Chair:** Silvana Tenreyro appears before us in connection with her reappointment to the MPC. Silvana, welcome to the Committee. Would you mind very briefly introducing yourself, please?

Professor Tenreyro: I am Silvana Tenreyro. I am an external member of the Monetary Policy Committee.

Q2 **Chair:** Once again, welcome to the Committee. This is the same question that I asked Andy at the start. You have been on the committee as an external member for a little while now. Are there any particular lessons you have learned during that time? Are there any views you may have taken in the past where you thought, "Actually, with hindsight, that was not the right approach at that particular time"?

Professor Tenreyro: I would echo Andy's answer. There was a lot of learning and many lessons. In terms of mistakes, if we are judged by our remit, I think we did fairly well. In these last three years we have kept inflation around target. The average inflation rate in the last three years has been 2.1%. The absolute average deviation from target has been 50 basis points, despite the big shocks that we had certainly after the referendum. Unemployment has been 4% on average. If judged by the remit, the MPC has performed very well in this period.

I have learned a lot from the experience. There has been a lot of learning about the economy and monetary policy, certainly. Also, on the progress, there has been a lot of improvement in communications. The MPC has made a big effort in improving the accessibility of its communications, introducing layered content to the monetary policy reports to reach different audiences with different levels of background knowledge. It has made the monetary policy report more thematic as well, to facilitate understanding of what is going on in the economy and what the issues the MPC is discussing are.

There has also been progress on educational outreach with EconoME, which is an educational programme that is addressed at teenage students in secondary school. Recently, the Bank has also launched Money and Me, which is an educational programme targeted at primary school children. This is trying to fill some gaps in financial literacy that one can detect in some of the answers that we get to surveys regarding inflation.

Q3 **Chair:** Thank you, that was very interesting. You mentioned inflation early on in your answer there. If, in some months' time, unexpectedly inflation has spiked up, in your view what would it have been that might have caused that to happen? I know people are not expecting it to happen, but what is the scenario under which it could happen?

Professor Tenreyro: That is an interesting question. We would need to understand what the underlying sources are. For now, my central forecast is that, if anything, we will see deflationary pressures because demand is falling behind supply. What could drive a big increase in inflation that we are not factoring in? Perhaps a very disruptive transition out of the European Union that leads to a breakdown in supply chains—for example, a big disruption at the border or an exchange rate depreciation. Again, these are things that are not contemplated in my forecast. You are asking me a very difficult question, because right now, in my mind, the biggest pressures are disinflationary. I would imagine a large hit to the supply capacity of the economy that is not in my central forecast right now.

Q4 **Chair:** You feel that, in terms of the huge amount of demand that is being pumped in, and the fact that the supply side is suboptimal, for reasons of the health scare and social distancing, et cetera, there are no risks around prices spiking in that environment at all.

Professor Tenreyro: I feel very confident about monetary policy being able to tackle inflationary pressures. If there is a surge in inflation, we can always deploy our tools. We can raise rates and eventually unwind QE. We have those tools to comply with our remit, so that is not a concern.

My biggest concern right now is that we face disinflationary pressures because demand is very weak for a number of reasons. I can go on: health risks will have a big effect on social consumption sectors like hospitality and travel. These risks are not going away any time soon. This will lead to voluntary social distancing in those sectors and reduced consumption; this reduced demand will in turn feed into higher unemployment levels and lower income, which will reduce demand for other sectors. This will be accentuated by precautionary behaviour, given the high unemployment and high risk to incomes.

We are also facing a very weak global outlook, with high uncertainties, particularly if a second wave strikes in the winter without a vaccine. It is true that there is a risk of supply factors. We will see lower productivity, given the reduction in investment during the crisis and scarring in the labour force; there will be a loss of job-specific skills and a deterioration of health, both physical and mental. These are important issues, including also social distancing regulation in the workplace and so on. The demand factors are likely to outweigh those supply concerns. We are seeing it in the price pressures in the CPI we have seen so far. On top of that, there is of course globally a large fall in energy prices, which will put even more downward pressure on CPI inflation.

Chair: That is very interesting. Thank you very much indeed.

Q5 **Rushanara Ali:** Good afternoon. To pick up on some of these points, and starting off with the written evidence, you said that, as long as the current period of high unemployment remains temporary, there should be only a limited loss in skills. You quite rightly stated just now that there are wider considerations like psychological wellbeing and how those things then impact on people's ability to get back to work and so on, and the impact on their skills. How has the announcement around the CJRS and SEISS by the Government affected your thinking on unemployment and skills?

Professor Tenreyro: Let me say that I wrote that statement quite a few weeks ago, and obviously I have been updating my own outlook. The JRS—the job retention scheme—has been incredibly helpful in supporting workers temporarily out of work and also supporting demand. There are obviously some concerns when people are not working, and those are the ones that can generate a depreciation of skills; and the more people stay out of work, the more those skills depreciate. It is a concern that, as we go forward, those issues become more relevant. My knowledge of psychological scars is very anecdotal, but we read about mental health consequences and that could have an impact going forward. The more time that elapses with people out of work, the more we risk those scars appearing.

Q6 **Rushanara Ali:** Just briefly on that, given the scale of unemployment and the shock of what has happened within households, in individual people's lives, and the ramifications in the wider economy, do you think that we need to think much less anecdotally, albeit that it is very welcome and refreshing that you are doing that? I have rarely heard Bank of England players, whether they are on this committee or other committees, speak about this issue, which is important. Given what has happened, we need to factor that into our economic analysis around reskilling, structural unemployment and return to work, given that the nature of what is going on and what has happened is so unprecedented.

Professor Tenreyro: When we think about human capital as economists, we think about it broadly. It is about education levels; it is about health levels. Those are important considerations and they should definitely be factored in when we assess the costs of unemployment and the costs of different policies.

Q7 **Rushanara Ali:** In terms of the idea of a V-shaped recovery and what could interrupt it and so on, can you set out where there is convergence in thinking and where you part company with Andy Haldane in the thinking around what kind of recovery we will have?

Professor Tenreyro: I made my view very clearly in my speech last week. I think we face an interrupted or incomplete V-shaped trajectory. Economic activity collapsed in the first half of the year by nearly 25% relative to the peak last year. I have argued that we should not focus too much on the exact numbers. The fall in activity was not a typical recession. It was a direct consequence of the lockdown measures introduced to protect public health. The exact size of the GDP fall will depend on how many businesses were closed down and when they were able to open up. The initial step up in activity that we are seeing should come quickly and mechanically as businesses reopen. For sectors that were constrained only by the lockdown, we should initially see a relatively V-shaped trajectory or jump. The big uncertainty is how much of the V will be interrupted by other factors weighing in on demand and supply.

Q8 **Rushanara Ali:** Would you say that actually you are not that far apart in terms of your thinking ultimately? Andy was talking about some of the unknowns, some of the dimensions around what would happen later on in the year and so on. On the face of it, it looks like you are the pessimist and he is the optimist—perhaps a blind optimist; who knows? I do not think he is listening—but is there actually much more commonality between your thinking, or not?

Professor Tenreyro: That is probably right. You might want to ask him. My view is that some of the factors he is concerned with and he is putting on the risk are part of my central forecast. I think spending in many sectors is going to suffer because of perceived health risks. This will drag on sectors like accommodation, food and travel. This will in turn feed into higher unemployment and lower incomes and hence affect other sectors, so there will be spillovers to other sectors, causing second-round effects that will add up. Again, this is very central in my forecast. Perhaps it is treated more on his risk side, but we are probably closer.

Where I differ from him is in how much I read from the fast recovery. This is tracking the lockdown measures. My big concern is voluntary social distancing as we exit the mandated closures. I also judged back in June, differently from him, that demand was falling behind supply significantly, so it needed an extra stimulus from monetary policy, and hence I voted for an expansion in our asset purchases.

Q9 **Mr Baker:** I need to refer a third time to my shareholding in Glint Pay. Earlier on, Professor, you said we can always raise rates and eventually unwind QE. I think that is broadly what you said, but that would have an effect on the public finances, would it not?

Professor Tenreyro: Obviously if we raise rates it will have an effect on all borrowers, including the Government. As I also tried to make clear, I do not think that is a very likely scenario right now. We are facing disinflationary pressures. The challenge for us will be to get to the inflation target from below, not from above. I was responding in the very unlikely scenario in which we would face a surge in inflation above our target, which I do not see as plausible right now.

Q10 **Mr Baker:** That is a thing we covered in the last MPC panel, but I think you were not included on that panel on that occasion. I want to turn to nominal GDP targeting. I think you will have heard my exchange with Andy. I am looking at a *Times* article from 25 June. It points out the Policy Exchange, the Centre for Policy Studies, the Adam Smith Institute, Sajid Javid and Gerard Lyons, all people close to Boris Johnson, are all coming out for nominal GDP targeting. You referred to it in your speech, but you left your options rather open. You said a nominal GDP may allow the Bank of England to consider all in the round, rather than having to prioritise inflation over growth and employment. I wonder what is going on. You sound a little warmer to nominal GDP targeting than Andy Haldane did. What is your view?

Professor Tenreyro: This is of course a matter for Government to decide, not for me, but let me speak as an academic. Let me first make a distinction. There is a lot of confusion between nominal GDP growth targeting and targeting on nominal GDP levels. If we had been targeting nominal GDP growth during this pandemic, we would have needed a massive monetary policy stimulus to offset the large fall in activity we have just seen. This would have caused unprecedented inflation. This is under the assumption that GDP would not have responded, given the non-pharmaceutical interventions we had in place during the lockdown. Conversely, in the coming quarters and next year we would have needed to withdraw all of that stimulus and in fact we would have needed massive deflation in order to meet GDP growth targeting, so I do not think it is a very good idea for shocks like this pandemic.

Targeting nominal GDP levels generates a little bit less variability in a situation like the pandemic and it might be more appealing, particularly when you cannot distinguish between supply and demand shocks. It would not have been so advisable in the aftermath of the financial crisis, with the big change in trends. That would have led to very persistent and high inflation for many years, until we eventually figured out that productivity growth had changed its trend.

Like Andy, I think that you can achieve many of the benefits of nominal GDP targeting in levers just having a flexible inflation targeting like the one we have. Nominal GDP targeting weights are very arbitrary: 50% real, 50% inflation. With flexible inflation targeting, you can adjust those weights, and so, in that sense, it is much more appealing.

There is yet another advantage of flexible inflation targeting. I think people understand inflation better, whereas GDP is a harder concept. It gets revised a lot more than prices. GDP is marred with technical challenges and difficulty, both in the measurement and interpretation, so it is much harder for people to understand what a central bank doing nominal GDP targeting is. Personally, I think that flexible inflation targeting is much more advisable. Again, this is my thinking as an academic. This is something that is for Government, not for us, to decide.

Q11 **Mr Baker:** You have made that point very clear. That was very helpful and interesting evidence. To what do you ascribe the emergence of this idea of nominal GDP targeting coming out into the public domain through these various think-tanks? Have you seen any evidence for what the source of this idea is? I have been in Parliament for 10 years talking about monetary economics and I have known about nominal GDP targeting as an idea for a long time, but it has not emerged into the debate. Why has it emerged into the debate now?

Professor Tenreyro: It was always a very present debate in the context of emerging markets, given the difficulty distinguishing supply and demand shocks. The thinking was that, in advanced economies, most of the shocks you face are demand shocks and then the supply-side capacity tends to be more stable. In the context of emerging and developing countries, there has been a lot of discussion. Jeff Frankel from Harvard has been a big advocate of introducing nominal GDP targeting in emerging and developing countries. I do not think any country has adopted it.

The idea is that, if you are an inflation targeter and face supply shock, that leads to an increase in prices. If you are targeting inflation, you would end up withdrawing the stimulus and causing a bigger contraction in the economy. If you are doing nominal GDP targeting, you accommodate to the shock, so it is less damaging in the face of supply shocks.

I cannot exactly say what drove this recent wave of thinking. One possibility is that people were more concerned about supply shocks with the crisis with Brexit and perhaps with Covid, but, as I said, I do not see Covid as necessarily a supply shock. It is an omnibus of both demand and supply shocks. At the end of day, I think the demand forces will dominate.

Q12 **Mr Baker:** The proposition that was printed in the *Times* was that nominal GDP targeting would enable the Bank to pursue a more expansionary policy during downturns. The idea is that the central bank will tolerate higher inflation when growth is weak but act sooner to rein in inflation when growth is strong and so on. The point they are making in this *Times* article is that nominal GDP targeting could enable the Bank of England to support more expansionary fiscal policy from the Government, by keeping going the current cycle we have, that actually the Bank of England is buying more bonds than the Debt Management Office is selling. Do you recognise that phenomenon?

Professor Tenreyro: No, sorry. I guess it depends what kind of numerical targets they are thinking of. I should read that article. I do not know what they have in mind.

Mr Baker: Fair enough. You have given us some extremely helpful evidence on nominal GDP targeting. I am very grateful. Thank you.

Q13 **Julie Marson:** Hello Silvana. I am sure it will not have escaped your notice that you are the only woman on the MPC. I do not know if you heard Andy Haldane saying how important he thought it was to have what he called a wide-angled lens when it comes to having diverse and independent views. Why do you think you are the only woman on the MPC?

Professor Tenreyro: To answer your first question, yes, I saw Andy. I was very pleased that you asked Andy , because normally it is women who get asked the question of diversity, and we end up talking more about diversity than economics, which is self-reinforcing in the end.

It is a broader issue with the profession, not just the Bank. The lack of diversity has many deep roots. One problem in itself is the lack of role models. We often hear that relatively few girls or young women choose economics as a subject. The question is why? The lack of role models is a big part of the problem. Women and young women do not identify with role models. From very early on, they are receiving the message that economics is not for women. That is shocking, because most women and girls care about all economic issues: poverty unemployment, inflation, climate change, education and so on. It is really shocking that few women are choosing economics as a subject. We face that problem from very early on.

A second factor that we know is there is unconscious bias. There is growing evidence of that happening. It is very important to educate people, both men and women, that we carry these biases and we need to act against them.

There is a third problem: workplace rules and norms. Finance and economics are fields where the rules of the game were set by men. There are many things that can be done to adjust to a more female-friendly environment: for example making maternity leave more accommodating, having more flexible hours, socialising around more inclusive activities and not just football—though I like football—perhaps making the discussions less confrontational, scheduling meetings at times that are friendlier to young parents and so on.

I do not want to go on and on. I have been working in economics for many years and there is some progress being made, but it is always behind what it could be. Sometimes you have to be bold and go for it. If there are some women, appoint them. That will certainly address it.

Q14 **Julie Marson:** We have certainly heard from people like Gita Gopinath, who have been absolutely amazing role models. Do you think we give women and other diverse communities enough of a platform? Do you think we should be doing more about that at Government level, Treasury level and at the Bank as well?

Professor Tenreyro: Given the imbalances, it is not enough. More should be done. There has been a lot of progress but starting from really very low levels. The Bank has made enormous efforts to improve diversity. It is a really nice environment to work in. I always felt very comfortable in the MPC in particular. You asked Andy if there is a problem with the MPC. I think people are applying. The appointments for externals is done by Treasury, so that is not something the Bank is to blame for. The encouraging part is that there are many young women in the Bank who are terrific economists. Yes, I hope to see them in the very high positions as time goes by.

Julie Marson: Me too. Thank you very much.

Chair: Silvana, thank you very much indeed for appearing before us again. That was a very interesting session. Thank you very much.