House of Commons

Treasury Committee

Oral evidence: Economic impact of Coronavirus, HC 271

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Harriett Baldwin; Anthony Browne; Felicity Buchan; Ms Angela Eagle; Mike Hill; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 927-987

Witnesses

I: Andrew Bailey, Governor of the Bank of England, Dame Colette Bowe, external member of the Financial Policy Committee, Alex Brazier, Executive Director, Financial Stability Strategy and Risk, Bank of England, Sir Dave Ramsden, Deputy Governor for Markets and Banking, Bank of England, and Dr Gertjan Vlieghe, external member of the Monetary Policy Committee.

Examination of witnesses

Witnesses: Andrew Bailey, Dame Colette Bowe, Alex Brazier, Sir Dave Ramsden and Gertjan Vlieghe.

Q927 **Chair:** Good afternoon and welcome to this latest session of the Treasury Committee and its inquiry into the economic impact of the Coronavirus. I am delighted to be joined this afternoon by five people on our panel, and ask them very briefly to introduce themselves for the public record.

Andrew Bailey: Andrew Bailey, Governor of the Bank of England.

Dame Colette Bowe: Hi, I am Dame Colette Bowe, external member of the Financial Policy Committee.

Alex Brazier: I am Alex Brazier. I am the Bank of England's executive director for financial stability and a member of the Financial Policy Committee.

Sir Dave Ramsden: I am Dave Ramsden, Deputy Governor for markets and banking at the Bank of England, and a member of the MPC and the FPC.

Dr Vlieghe: My name is Jan Vlieghe and I am an external member of the Monetary Policy Committee.

Q928 **Chair:** Thank you. The way we are going to run this is that there will be various questions from the members of the Committee. Members will endeavour to identify the person or persons to whom they are directing their questions, but if you feel you are not being brought in on a particular question and you have something you really wish to contribute, do not hesitate to raise your hand; I will endeavour to bring you in at that point. Alternatively, you can always write to the Committee at any time with your thoughts, and we are always happy to hear from you in that way.

I would ask everyone on the panel, particularly as we have five panellists today—it is quite a large panel—to be as brief and succinct as you can in your answers, please. I know that is sometimes difficult, because there is a lot to discuss, but I would be very grateful if you kept that in mind.

The final thing to mention before we get going is that there may well be a Division in the House at a little after 3 o'clock, perhaps about ten past 3. In the event that that happens, I will suspend the Committee for 15 minutes to allow members time to participate in that Division, if they wish to do so. Then we will reassemble after 15 minutes. I just alert you to that possibility. That Division apart, we do not think there is likely to be any other interruption to our proceedings today.

That all said, thank you very much and welcome to each of our panellists joining us today. I want to start with a question that I would like to direct to the three members of the MPC who are before us today, and to go back to the meeting of the MPC on 4 August. In particular, there is a little quote that I will read from the minutes of that meeting: "Overall, the risks to the outlook for GDP were judged to be skewed to the downside, albeit that different members placed different weights on the nature and the scale of these risks." I wonder whether the MPC members on the panel could comment on that and explain those different weights and the kind of the debate that there was around that point. Let's start with Andrew.

Andrew Bailey: That is a very good place to start. Let me make two points about the fan chart. There are two very interesting points. One is what we tend to call the skew: the size of the risk. The risk in one direction was probably one of the largest ever—the risk to the downside. The other relevant measure on the fan chart is the width of the fan chart, which is the measure of uncertainty. That is the largest measure of uncertainty that there has ever been in a fan chart in the history of the MPC, which is getting on for nearly 25 years now. In a sense, that is a way of describing the world we are in.

I think there was broad agreement on two things. One is the fact that we are in a period of very heightened uncertainty, so the debate was not really around the scale of that, or that there was going to be a downside skew. As you say, it was really around some views on what makes up that skew, where obviously a lot of things come into play. I will give you my own view, and in the interests of brevity I will really focus on two things.

I think in the short run, clearly there is a lot of uncertainty and different views around the question of how much of what we call "natural caution" enters into the behaviour of people in the economy as we go forward. We did not make any assumptions about vaccines; we did not make any assumption about the precise pattern of Covid going forward, because frankly we don't know. In many respects, we feel that there will be a gradual alleviation, as we have seen, and the capacity to treat Covid appears to me to be increasing, for which many congratulations to the health service. However, there are different views about the course of that and obviously there are different views about how that relates to the exercise of natural caution, as people re-engage with the economy. That is the first point.

The second point of the two that I will highlight is what many of us call the structural point. How much structural change will there be in the economy as a consequence of the shock that has happened? I am sure we will come on to that as this session goes on. How is that going to manifest itself? How are we seeing it now? The extent of structural change is important, because that is the thing that can lead to what we tend to call scarring—longer term dislocation of pieces of the economy, if you like—and it can lead to longer term unemployment and a raising of the natural rate of unemployment for some period of time. Those assumptions are, first, critical to the economy and, frankly, critical to people's lives, and secondly, there is a lot of uncertainty around them, so to reply to your question, there will be different views on exactly how that will unfold.

To finish, we have an assumption in the forecast that roughly just over 1.5% of GDP is represented by what we call long-term scarring, which, to put it precisely, means that if you go back to the inflation report in January—pre-Covid—and compare the outturn now with the outturn then, it is about 1.5% lower at the endpoint. That is a way of capturing the numbers, but I stress that there is a huge amount of uncertainty around this. I think that this structural change issue is going to loom large for all of us in the forecasts to come. I will stop there, Chair.

Q929 **Chair:** That is very helpful and succinctly put. Thank you.

I am going to Dave now. Dave, in your response, perhaps you could flesh out a little bit this point on scarring, and say which specific areas or sectors in the economy the Bank is particularly casting an eye over in this respect, as you monitor the recovery.

Sir Dave Ramsden: I am happy to contribute on this, because I think it is very easy to focus on the very short term, but actually I think these longer term issues are absolutely critical in terms of assessing how the economy is going to look once the Covid shock has passed through it.

From my perspective, these really are issues of judgment at present, and that is why there was a healthy debate on the Committee as to the kind of channels for potential scarring. As Andrew has just said, we have only really allowed 1.5% of GDP as a permanent impact, so we think that once we are the other side of the Covid shock, the level of GDP will be permanently about 1.5% lower. For me, all the risks are really that that number will be greater than 1.5%, and I can give you a few of the channels but also suggest some of the adjustment that might have to take place.

What we have tended to focus on in this forecast, as Andrew emphasised, are the potential impacts through the labour market, where we have allowed for some degree of mismatch in the labour market persisting. That is because, as the economy adjusts, certain sectors will be—we are already seeing it—impacted more than other sectors. Jobs will be lost in those sectors, and we think there will be a mismatch in terms of the skills of the people who have lost their jobs in those sectors and their ability to move into the growth sectors of the economy. That is one area where we have made some allowance and revised up the medium-term path of unemployment.

In other areas, potentially, as we see the next phase of the recovery unfold, we will be able to assess just how great this sectoral impact is on the labour market, but we will also be able to look at the degree to which the UK economy is repurposing through this shock. There has been lots of focus, for example, on what might happen to the commercial real estate sector as it is likely there will be a semi-permanent effect, if not a permanent effect, coming out of this shock, reflecting both what we have discovered about people's abilities to work from home in many sectors, particularly in certain service sectors, but also natural caution. We might find that there is less demand for commercial real estate in city centres as currently configured, so that commercial real estate will probably see less investment in the immediate future. Will that add up to a less productive or a more productive economy? That is an open question, and we have not really drawn any conclusions on that at this stage, but that is the kind of mechanism that you would want to consider and to ask yourself whether there might be more permanent scarring on productivity alongside the labour market.

A final factor I would mention is capital deepening. How much investment goes into certain sectors? For example, one of the sectors where we have seen a lot of growth in employment in recent years is retail. As more retailing moves online, it might be that more investment could take place in retailing in terms of capital stock than in labour. That would obviously have an impact on the labour market—one of the three channels I have identified—but it could also lead to greater productivity over time.

This is a really complex set of factors to untangle, and we and others are only really starting to scratch the surface and think about this. I think our estimate of a 1.5% impact of scarring is a good starting point on thinking that there will be a permanent effect, but as I say, unless the adjustment is very quick and happens quite easily, the chances are that the scarring effects over time might be larger than that. Obviously there will be an interaction with policies, but at the moment we have made that assessment. We have also highlighted that the risks overall are that the scarring impact could be greater than a shortfall of GDP of 1.5%. I will stop there, Chair.

Q930 **Chair:** Dave, thank you very much. That is very helpful. I want to come to Jan. I am a little bit tight on time now for my section, so give a fairly short answer if you can. Could you pick up on this productivity point? I think, having looked through the minutes of the meeting, the point was made that on the one hand you might have a move from labour-intensive sectors, which might help drive up productivity, but equally a lack of capital investment might be a drag on productivity. It seems that, as Dave has suggested, it is not clear which way that might break. Do you have a view on what might be going on with productivity as we come through the recovery?

Dr Vlieghe: I think that tension, between those two forces of productivity lost from people having to reallocate to sectors that they are less expert in, but potentially productivity gained if they move to sectors that have higher productivity, is exactly the tension.

The thing that I want to emphasise briefly, which is a slightly different focus, is that it is not a good idea as monetary policy setters to focus too much on the supply side of the economy in isolation, as if you can think of that separately from the rest of the economy. What I mean by that is, if we are considering scenarios where the economy needs to undergo much more structural change, meaning that potentially the unemployment rate is going to be elevated for a much longer period of time, that is also an economy where demand is going to be weaker and therefore an economy that is going to need more monetary and fiscal stimulus to close spare capacity and get back to running at full capacity.

Where my focus is slightly different from the previous discussion is that I think the risks are on the downside in terms of the output gap and the evolution of the output gap. In the current forecast, as a central case, we have that most of the output gap is closed in about a year or a year and a half's time. I think that is quite quick, and that the idea that with the current setting of monetary and fiscal policy we move into excess demand in the second half of the forecast period is rather less likely.

Chair: Thank you very much. I would now like to go to Harriett.

Q931 **Harriett Baldwin:** I am going to ask about inflation, so again, it is mainly for members of the Monetary Policy Committee, perhaps starting with Dr Vlieghe. What are the market signals, particularly the price of gold, telling you about inflation expectations?

Dr Vlieghe: A couple of things about gold. First, it is a terrible idea to look at the nominal price of gold, because it is a nominal price and therefore it is expected to go up over time. Even if the gold price was very stable, you would expect it to set a new record every month, so the fact that it is at an all-time high tells you precisely nothing.

A better idea is to look at the real price of gold, which is elevated but not at a record high. But if you look at previous episodes where the gold price was elevated, you realise quickly that gold is a terrible predictor of inflation, because the previous times when gold was a little bit higher than it is now but at historical peaks were in the early 1980s, which was the beginning of a long decline in inflation, and in 2011, which was also the beginning of a long period of weak inflation. So gold is a terrible predictor. We do not look at it very much as an indicator of inflation.

We spend much more time looking at both surveys and financial market measures of inflation expectations. What you see there is that in the immediate aftermath of the economic damage from Coronavirus, all those expectations went down. Given all the fiscal and monetary stimulus since then, we have just about been able to bring them back to pre-pandemic levels. They are not elevated at all; they are in line with the target. They have been rising from depressed levels and they are now at more comfortable levels where we think it is consistent with the target.

Q932 **Harriett Baldwin:** Thank you. Sir Dave, I noticed that in the most recent charts, inflation expectations are also extremely wide in terms of the possible ranges, and the deflationary risks have gone up slightly since the January charts. Do you think deflation is a bigger risk than inflation at the moment?

Sir Dave Ramsden: In the August monetary policy report, we recognised that there was a downward skew on inflation as well as on GDP. It is also worth saying, though, that because there is the interaction between supply and demand effects that Jan was just highlighting, I think the inflation fan and the downward skew is probably not as great as it is for GDP. So yes, I think that disinflationary risks have gone up compared with January.

I would also put some emphasis on the supply-side factors that might mean there is less spare capacity than you would otherwise think, given the fall in demand and in headline GDP that we have seen. As Jan has just highlighted, financial market expectations, but also the survey indicators that we review of household and business inflation expectations, certainly for the UK, suggest that inflation expectations, despite this shock, have recovered and appear reasonably well anchored.

For us as the Monetary Policy Committee, that can give us some comfort, but you obviously have to be very vigilant when you have had a shock like this and when the skew is to the downside, because you want to avoid a situation where weaker inflation expectations become entrenched. For myself, I am comfortable with where inflation expectations are at the moment, but I was still voting back in June and again in August to continue with stimulus, consistent with the forecast that showed inflation coming back to target by the end of the forecast horizon, and finishing very marginally above target at 2.2% in the final year.

Q933 **Harriett Baldwin:** Thank you. Governor, in terms of where we are overall in monetary policy, if it were a car would you say that your brakes work better than your accelerator?

Andrew Bailey: That is an interesting question. We certainly had to put the accelerator down very hard in March and onwards, as you know. I used the phrase "go big and go fast" in the remarks I made at Jackson Hole—or not at Jackson Hole—on Friday. That may have a certain driving analogy, although not the sort of driving any of us should do, obviously. In that sense, we used policy very aggressively. I emphasised the point on Friday that in August we also did a further round of quantitative easing of £100 billion, which will continue in terms of its execution through to about the end of the year, but the other point made in August is very important, because we also did something of a pivot towards forward guidance in terms of the use of policy tools.

That is important, because what we said in August in the guidance was that we were going to require more than what you might call normal evidence and assurance that the economy really is on track to meet the projection that Dave and Jan have described in the central case. That goes straight to the point Jan made about the risk to the downside and the output gap. We were very deliberate in August in using forward guidance. It is a different pedal—to stretch the analogy to breaking point—but an important one at this point, to give a clear signal that because of the uncertainty and the risks, we are going to need more than normal evidence and assurance that the economy is on track and therefore inflation is on track to return to target before we act.

Q934 **Harriett Baldwin:** Can I ask a bit further on that? Where the economy has returned, there seems to be some evidence of the sectors that are returning raising prices. For example, hairdressers have put up their prices by 5% and potentially theatres might have to charge more because you have to sit more distantly. How does the Monetary Policy Committee look at that, Governor? Is it seen as a one-off or as something that could lead to more sustained inflation?

Andrew Bailey: There are a couple of things there. You are right that we are seeing evidence of certain activities where the costs of conducting the activity have gone up and there is a commensurate reflection in the pricing. Interestingly, and this may be on the same point, it is about a month now since the August report and I would say that the most likely short-run path of inflation is higher than we had it in the report. That may be partly for the reasons you have given, but probably more—this may be part of the same story—because we made an assumption in the report in particular about the pass-through of the VAT cuts. That will be a short-run effect. I think the evidence we have had since then, particularly from our regional agents, is probably that the pass-through was weaker than we assumed it would be a month ago. That will tend to cause short-run inflation to be slightly higher than we thought it would be.

It probably will not now go negative, according to our best guess. We thought it would very briefly go negative, through a combination of VAT and also the way in which the "eat out to help out" scheme was accounted for in inflation. VAT pass through looks a bit weak. That may be for the reason you give, that people are absorbing increased costs by not passing on in that way. Fuel prices, oil prices, are a bit higher than we thought they would be. They have gone up a bit more.

The second key point, of course, is a very traditional point, about which you rightly say: how will we look at that as a Monetary Policy Committee? Well, those are what we tend to call first-round effects. What, of course, we are very interested in looking at is do they pass through to second-round effects. That is where I tend to go back to what Jan and David said; that is where inflation expectations are critical. I will just finish on that. So far, and particularly in market pricing, UK inflation expectations have been pretty stable, actually, through all of this, which is interesting given, obviously, the amount of volatility we have had going on during the course of this year.

Harriett Baldwin: Thank you very much, Governor. I think my time is up.

Chair: Thank you, Harriet. I am going to go now to Angela, please.

Q935 **Ms Eagle:** Thank you, Chair. I want to spend a little bit of time on the labour market, because obviously we are approaching a very important juncture, with the beginning of the winding down of the furlough scheme. The Bank of England's work, and its forecast, was basically saying that you expect a material rise in unemployment, and you are expecting it to double from 3.9% to 7.5%, with average earnings going down. Do you think there is anything that you should be doing as a Bank, to encourage this rise in unemployment not to be as high? Something specific?

Andrew Bailey: Let me be clear. Of course none of us actually wants to see a rise in unemployment of that nature, so we should use all our tools to do all we can to prevent that happening. What we are seeing, now, is that there has been quite a sharp reduction in the use of the furlough scheme already. I think at one point about 30% of private sector employees were on it. It is now down to about 13%, or 14%, but it is sort of flattening out.

The other thing I would say—and I think this is one of the interesting points—is that actually, unsurprisingly, it is becoming much more concentrated in terms of the sectors of the economy that are using it. So it has gone from being quite a general phenomenon to more activity-concentrated. So if you look at something like arts and entertainment, for instance, quite a high proportion of people who work in that sector are furloughed, still.

I think that has two effects, in terms of policies—and, by the way, they are not really for us, I should say. One is that I think it does support calling into question what is the right way to support the economy going forward as we switch from a more generalised labour market issue to a more focused issue. Secondly, going back really to what we were talking about earlier in terms of the question of structural change and to what extent we will see not only unemployment going up if we see people shifting, as Jan was saying, from activities and having to go into activities that they are initially at least less well trained and qualified to do, but how much longer-term unemployment we will see. History would suggest we will see it at that point, and that's what lies behind quite a bit of our assumption that we will get an increase in unemployment.

By the way, I should say that that number of 7.5% was of course about 2% lower than we had in the simulation that we used, and the scenarios that we used, in May. But I think the question then is to what extent will we see this structural change, and to what extent there are policies—not really monetary policy, I should say, which obviously can be used to help to alleviate and shorten the impact of that.

Q936 **Ms Eagle:** Governor, in the BBC interview in August you backed the Chancellor's decision to unwind the furlough scheme. Why were you supportive of the unwinding, and why did you make that support public in the way that you did, especially given that other countries aren't actually ending their support?

Andrew Bailey: Let me say this. For the reason I just gave, I think it has got to the point where a scheme that was designed, very sensibly, for a general labour market feature—30% of the population not being able to work—has changed. The labour market has changed and the nature of Covid has changed: it is much more specific now in terms of the effects it is having. Therefore, the reason I said that in August, and I still support it—I am not going to put words in anybody's mouth as to what should be done, because these are Government issues—is that the change in the nature of the issue requires a change in the nature of thinking about what the right policies are to address it.

Q937 **Ms Eagle:** If there is, as you rightly point out, a focusing down of the problems to very specific areas—you mentioned entertainment, leisure and culture—does that not argue for a similar focusing of furlough to make it more sector specific, focusing support on those places that, through no fault of their own, have been affected by the aftermath of the Coronavirus challenge and are still closed or cannot operate, such as theatres that used to rely on 90% ticket sales to break even but now have a much reduced capacity?

Andrew Bailey: That is a very important and interesting question, but it is really outside the Bank's remit. It is right to say that the nature of the question and the challenge has changed. I do not think, honestly, that is one that the Bank can answer.

Q938 **Ms Eagle:** In your speech, you talked about the hit to the economy being not as high as you had expected it to be in May. That is obviously good news, and I hope that you are correct rather than the OBR. But the assumptions underlying that were that there would be no big second wave of the virus and a free trade deal with the EU would be in place without too much bother at the end of the year. Neither of those things is necessarily very likely to happen—or at least they are mired in uncertainty, aren't they?

Andrew Bailey: Let me say two things on that. That goes back to the first question that the Chair asked about why we have got such a big downside skew on the forecast. A lot of things can be in that skew. One is that we have, unfortunately, a quite large-scale repeated series of local restrictions in the context of Covid. We are not making any predictions on what those would be; we are merely saying that that skew can accommodate a lot of that, as it were. If you look at the width of the skew in the forecast, it is a very big number in GDP terms. So that is within the scope of the risks we see.

On the second thing, trade and the question of the EU, let me first of all be clear on what is in the forecast. We always condition our central case on Government policy. It is conditioned, therefore, on a CETA-style trade agreement. The downside skew—again, you can put quite a lot of things in the downside skew, because you can have combinations of things—would certainly accommodate a WTO-style outcome. What I would say is that, as we now build up and will build up to the early-November monetary policy report—the next one—I expect that we will focus not only on those things but also the key question, which is: how much disruption, or not, might there be to trade, and therefore to the economy, at the turn of the year? We will certainly be focusing on that. But once again I reiterate that that downside skew holds the scope to have a lot of things in it.

Q939 **Ms Eagle:** Dr Vlieghe, you said in your evidence to us that at some stage jobs do need to move, but, given the extent of the structural change that Covid-19 might have initiated in the economy, you are worried that it may take longer for the economy to return to a trend similar to what we expected prior to the emergence of the disease. Could you say a bit about how worried you are that that recovery will take much longer and what pressure it may be putting on our economic recovery, and whether you think that trying to pursue much faster structural change using policy would help that, rather than hinder it?

Dr Vlieghe: The point I was trying to make starts with the scenario we were thinking about at the beginning of the year, which it turns out was rather optimistic. We thought, "Hopefully, the virus is a relatively short-lived thing. It disrupts certain types of economic activity a lot, and other types of economic activity rather less, so you get some spare capacity opening up in certain sectors of the economy. As concerns about the virus fade away, the people who have been furloughed or who have lost their jobs in those sectors can be rehired in those sectors." That is a process that in principle can happen very quickly: of course, the easiest version of that is a restaurant, for example, that has furloughed some of its workers. At some point the restaurant reopens, and they take their furloughed workers back. That is an instant adjustment.

It gets more difficult if, for example, those workers need to find work in a different restaurant, rather than the one they were originally furloughed from. It gets even more difficult if it turns out that, for example, the economy has permanently lower demand for restaurant seats, and therefore some people who used to work in the restaurant sector need to move to a different sector. You then get into a scenario where, rather than having this relatively rapid labour market recovery, that recovery probably starts to look more like it did in previous recessions.

To put some numbers on that, the average across the last three recessions was that in the first five years of the recovery, the unemployment rate fell by about 0.8 per year on average. In our forecast, we have it falling by 1.2 per year over the next three years, so that is faster than the historical average. I think it is reasonable as a baseline, because as I said, you can expect some reintegration of furloughed workers to be a fairly rapid process. However, to the extent that there are some people left at the end of that who cannot go back to their original job, I would expect more traditional labour market dynamics for that part of the labour force. That means that it takes much longer for the unemployment rate to decline, because these people need to retrain, look at different sectors, and possibly even move to different parts of the country depending on what the circumstances are, which takes much longer and is much more difficult. That is the point I was trying to make.

Ms Eagle: Thank you, Chair.

Chair: Thanks, Angela. I will go to Felicity now, please.

Q940 **Felicity Buchan:** Thank you, Chair. It is great to see you all, and I thank you for taking the time. My questions are on consumption and household saving. Let me start with the Governor, and then I will bring in Alex and Colette, because I am conscious that you have not yet talked.

We have clearly seen some good data on consumption over the course of the last few days. Retail sales data for July was positive, and we have seen very good housing data today, both in terms of prices and activity. How much comfort do you take from this, and is there a risk that all we are seeing here is delayed expenditure and that it could peter out quite quickly?

Andrew Bailey: As we said in the report and as was said earlier, the collective view of the committee was very cautious, in the sense that although we have seen a very pronounced and rapid recovery—I do not like using letters to describe this, so I am only going to use the letter V once—we are very cautious, and taking the view that we should not read anything literal into what is going to happen next as a result of what has happened.

You are right that household spending is now close to its pre-pandemic levels, but it is a pretty uneven picture, and it is uneven in a number of respects. It is uneven in terms of its make-up across different parts of consumption. As you said, we have seen a very rapid recovery of the housing market. The numbers that came out this morning on mortgage approvals are very strong. Throughout much of the period, what we tend to call "delayable spending"—things that people have a choice about when they do, such as home improvement spending and so on—has been strong, but what we tend to call "social spending", or the eat-out type, throughout the period has been very weak and has still not recovered strongly. So a very uneven picture.

We have also already seen structural change in spending. One of the most interesting facts that I can give you is about retail sales. If we look at retail sales in July, the level was I think about 1.4% higher than in July last year. Total retail sales in a month are about £37 billion. Within that, the share of online retail sales has increased from about 20% earlier in the year, before the pandemic, to a bit under 30%. Basically, that means, in a month, about a £3 billion surge in retail sales to online selling.

Sorry for this load of facts, but that really underlines the points that Jan has been making about how much we are going to see persistent, more structural changes as a result of this, and how much that will then brake—in the sense of car brakes, sorry—the path of consumption from here on. Our forecast suggests that after the third quarter, the rate of the recovery will slow. It has to slow, of course—it cannot go on that rate. Then, to reinforce what Jan has been saying, the question of course is, if we are to see structural change, at what speed will that process go forward, and at what cost in terms of consumption?

You are right that, so far, the recovery of consumption and household spending has been very fast. By the way, of course, that is to some degree but not completely offset by a very weak story on investment.

Q941 **Felicity Buchan:** Are you concerned about the regional disparities? I am pretty focused on London, because I represent a central London constituency, and clearly footfall is very low in London, and property activity is very low in London. Does that concern you, given the fact that London has been the driver of growth previously?

Andrew Bailey: It is certainly an issue in terms of the point that I made about unevenness. One of the most interesting experiences I have had—we look at a lot of very fast, real-time indicators at the moment—is to find that, when we look at the geographical distribution of credit card spending, the weakest area is London. That is probably for two reasons. I guess one is obviously the question of the return to work, and the other is the question of tourism. But you are right, there is an impact there. Again, that will have an impact. The unknown question, to come back to the point that Jan made so rightly, is about how that plays out in terms of whether there is more structural change in the economy.

Q942 **Felicity Buchan:** You also mentioned the move from high street retail to online retail. Are you concerned about the implications for employment with that move?

Andrew Bailey: I think we just fit that back into the story that in a sense we have raised a number of times already this afternoon: how much will that cause what one might call a structural change in, or a structural brake on, some areas of employment, and to what extent will that cause longer-term unemployment for people, who will look for new jobs or retrain? It is the point that Jan made.

Q943 **Felicity Buchan:** Thank you. Let me bring in Alex. We have clearly seen a substantial increase in household savings, especially in affluent families. Are you concerned that that will potentially delay the recovery?

Alex Brazier: I will make two points on that. First, a lot of that saving has in some sense been forced: people have still been earning their income, but they have not been able to spend, because of the public health measures. To some extent, it is not really an economic choice, but a feature of the circumstances in which people have found themselves.

In line with the earlier discussion about downside risks to the outlook more generally, these are all things that could explain some of the downside risks that Andrew, Dave and Jan were talking about. When it comes to the financial system, we have not for a moment hoped for the best; we have been planning and stress-testing the system for much worse outcomes than that contained in the central case in the monetary policy report. We may come on later to talk about those stress tests, but the central element, which is crucial for household saving and borrowing, is that, because the banking system in particular is much more resilient than it was back in 2007-08, it is not in a position where a downturn in the economy has forced it to rein in and tighten credit conditions and hold back from lending to households and businesses. Had we been in the position that we were in in 2008 with our banking system, we would now be in a full-blown banking crisis. As it is, we are a million miles from that. Credit conditions have tightened a bit in the mortgage market and in corporate debt markets, but they have not tightened any more than you would expect, given the economic uncertainty. As a result, household lending has got going again, mortgage approvals are back where they were a year ago and corporate lending has obviously been very strong—maybe we will talk about that later. We have not seen that retrenchment of credit supply, and as a result, households will not be forced to save to try to pay down their debts. That is a big difference from where we were in 2008, in the last recession.

Q944 **Felicity Buchan:** Thank you. You mentioned that the banking system has coped very well with people working at home. What do you think lies behind the reluctance of a lot of the big financial institutions to get workers back physically into the City?

Alex Brazier: We have seen economic activity get going again. We have seen activity in the financial sector in particular continue largely through this. However, I think there are two factors holding people back—by the way, this is not only a London phenomenon; you see this in lots of cities. First, people have a caution about the public health issues. I feel safe coming into work, but I can quite understand why many people might not. Public transport capacity is a related factor there. The other factor is of course that, with Covid-safe guidelines, it is not possible to use office space, particularly in central London and dense places like that, with the intensity that we used to use it, so it is actually not possible to bring lots of people back very suddenly.

While lots of us may want to come back—one thing that I have certainly learned from this is that there are merits to working in an office, when it comes to efficiency, collaboration and creativity, for example—because of those constraints, I do not think that we can expect to see a sudden and sharp return of lots of people to very dense office environments that we were used to. We should expect a more phased return, depending on the public health outcomes that we see over the coming weeks and months.

Q945 **Felicity Buchan:** Thank you. Let me now bring in Colette. We have talked about household savings going up. Do you think that this could become a permanent feature of our economy, and are you concerned, given the fact that it is more affluent families who are saving more, that we could have more entrenched wealth disparities going forward?

Dame Colette Bowe: Felicity, just before I respond to that, I would like to add something to what Alex just said about people returning to work. Alex, you did not touch on the question of children returning to schools, which is of course a major issue for a great many parents. They have to feel that their children are being properly cared for and that their education is being taken care of. I just add that point, Felicity, to the number of issues that Alex mentioned about returning to work.

We all have rather different views about this. I do not know whether it is obvious to you, for example, but four of your five witnesses this afternoon are speaking to you from the Bank of England. We are, as it happens, back in the centre of London, but not everybody feels like that.

Now, you want me to talk about savings behaviour. What can I add to what has been said? I think that the important point that Andrew wanted to emphasise to us was that it is hard for us to be clear at the moment how far the trends we are seeing are persistent. Alex also made the point that quite a lot of this saving is, in effect, forced saving—people have not spent on things that they would normally spend on. I think, Felicity, that the main point I would add to your very interesting one about distribution is that it is a little bit early to call that. Plainly, it is almost a sort of arithmetic point that better-off families had saved in this pandemic, but I would be very cautious about moving from that to drawing inferences about inequality of wealth distribution.

Chair: Dame Colette, I am so sorry to interrupt you—not least because you are making a very valuable contribution and it is your first contribution—but the Division bell has sounded for a Division in the House of Commons.

Dame Colette Bowe: Oh no!

Chair: We will come straight back to you when we reassemble. I am suspending the Committee for 15 minutes.

Sitting suspended for a Division in the House.

On resuming—

Q946 **Chair:** Welcome back. Dame Colette Bowe was making a good point before we suspended.

Dame Colette Bowe: Thank you, Chair. It is kind of you to say that, but it was actually a rather boring point. I was saying that it is a bit too early to tell what the distributional impact of this episode will be. As Andrew and colleagues have said, we are obviously observing interesting things such as savings behaviour. We are observing very interesting and, for many people, distressing labour market developments, but it is a bit early to call the longer-term implications of this for inequalities.

If I may, I would like to alert the Committee to the fact that the very distinguished British Nobel laureate, Sir Angus Deaton, is leading a major project on inequality in the United Kingdom, which will start reporting from February next year. That could well be the moment when we will start to see some hard facts on the impact on inequality.

Felicity Buchan: Thank you. I have now finished my questions.

Chair: That leaves us in an interesting situation, because I don't think that Steve is back with us yet. I wonder whether I might go to Rushanara on trade and international growth. Rushanara, would that be okay?

Q947 **Rushanara Ali:** That is absolutely fine. Good afternoon, everyone. I want to focus a bit more on some of the things that Angela raised, and in particular the emerging challenge that is Brexit, which we need to return to. Governor, where do you think things are at in terms of the range of outcomes for the economy and how the forecast would differ, including in the circumstances in which there is not a free trade agreement, and what that would mean? Can you talk us through what the worst-case scenario would be? If we have no deal and there is a second wave, what would that mean for the economy, and what interventions could the Bank make to try to reduce the even greater challenges, on top of what we already have?

Andrew Bailey: I won't go back over what I said earlier, except to say that I think the key question, which you rightly point to in what you said, is not so much what trade agreement is reached; it is how much disruption goes with it. Obviously, if there is a weak trade agreement or no trade agreement, the question is: does that lead to more disruption? As I said, that is a question we will be coming back to in November.

There are two important questions for us. One: has Covid had a first effect? Surveys that we had last autumn on this question suggested that about 60% of firms in this country felt they were reasonably well prepared. The question is: what has the disruption caused by Covid done to that measure of preparedness and the scope for disruption? That is one question that we will be coming back to.

There is a second question. Here it gets pretty complicated, I'm afraid. As you rightly asked, what if we have a big return of Covid and we have some trade disruption at the same time? The reason I say it gets complicated is that the problem is that both those things disrupt trade, and you cannot disrupt trade twice, so unpicking those two is complicated.

We started addressing that question in the August report, thinking about the fan chart. As I said earlier, we have a very big downside skew on the fan chart, so you have a lot of stuff that can unfortunately go wrong in that space. Based on the work we did in August, the short-term downside risk from Covid is much bigger. The disruption that Covid can cause the economy is much bigger in the model that we did in August.

In the longer term—and this is hugely dependent on whether we get, as I mentioned earlier, a gradual amelioration of the impact of Covid without seeing any sort of vaccine breakthrough—you might think that, relative to the shift, it takes longer for the economy to adjust to trade disruption. Disruption around the trade agreements and the Covid effect might come off a bit more quickly, but that is a judgment.

You rightly asked what would the Bank of England do. I hope that I can give you assurance on that front by what we did in March. I said on Friday, at the virtual Jackson Hole session, that it is very important that our policy framework is robust enough so that we can act. As I said, we can go big and go fast if we need to. Obviously, if we see the sorts of conditions that you were talking about, then you and we would expect, frankly, a sizeable reaction from the Bank and the Monetary Policy Committee.

Q948 **Rushanara Ali:** Could you just elaborate on what that might look like? I appreciate what you are saying about Covid risks being greater in the short term, but I want to push you a bit further, because the public will be looking at this and wanting to get a sense of what that combined threat looks like for us as a nation and what the Government need to do as well as what you will do in the Bank, and what others will do.

Andrew Bailey: For the fan chart back in August, we had broadly three international issues in mind: the first was obviously Covid, both domestically and internationally; the second was the question of how the trade agreement with the EU is going to come out; and the third, which we have not mentioned yet, is the broader geopolitical tension—the US and China. Those three things are all out there.

When we draw up fan charts, we do not precisely calibrate these things, because that is a hazardous business. But again, the fact that we have got a fan chart—I think I am right in saying that if you measure it at certain points, the edge of the fan chart, as a GDP level, which is somewhere like 12% to 14% lower than what it is at the moment, will give you a sense of the scale of the things that can go on in that. The interactions are very complicated.

As I say, all of those things could lead to a reduction in trade. We are going to do more work on that and more work on the state of preparedness. Hopefully, we can get a better reading on that as the economy comes out of the Covid shock.

Q949 **Rushanara Ali:** I have a final question to pick up on the point about big and fast. If we end up with the worst-case scenario, a doomsday scenario—of course, none of us wants that—what does big and fast look like, through the lens of your role in the Bank of England?

Andrew Bailey: Can I make three points about the toolkit? We have done a lot of work on the toolkit. Part of that work was summarised in the Jackson Hole speech that I made on Friday. First, I made the point that there is a lot of debate about how quantitative easing actually works—Ben Bernanke famously said that it works in practice but not in theory. We advanced, with some caution, the argument in that paper, based on evidence that, particularly in situations of market dislocation and economic dislocation of the kind we had in March—you are talking about what might come—it seems to have a bigger effect. It is a tool that is somewhat state contingent. That is an important lesson to draw about how we use that toolkit. As I said earlier, we have also pivoted to use forward guidance.

Thirdly, we have made it quite clear that we have done work on negative rates, actually since the last Treasury Select Committee hearing, when I set out what we would do. It is in the box of tools. We have no plans to use it imminently, but it is in the box. If it was the right thing to do, in response to the situation you have just described, and if it was the better approach than the other tools, the case for bringing it out of the box would be strong.

Q950 **Rushanara Ali:** That is really helpful, so thank you. Would anyone else from the panel like to come in on any of those points?

Andrew Bailey: I think it goes back to the hearings we had in that prehistoric age before Covid. I remember you talked to Mark Carney about this, and I think you talked to me about it at my appointment hearing. Both Mark and I were talking about how we calibrated headroom in monetary policy at that time. I made the point in my Jackson Hole remarks that we have done a load of work and, obviously, been through a very big situation. Frankly, looking back, as I said in my Jackson Hole remarks—hindsight is a brilliant thing when you have it—we probably underestimated the headroom that we now think we have, because we have done a huge amount of work to think our way through a problem.

Q951 **Rushanara Ali:** Sir Dave, you have your hand up.

Sir Dave Ramsden: I was just going to reinforce what Andrew was saying about the disruption that might come with a disorderly WTO or other deal, where there was disruption at the ports and such, there is obviously a limit to what we can do by going big and fast. However, if there was any sign that a combination of Covid and whatever happens on Brexit, or indeed any other shocks—Andrew alluded to geopolitical shocks and other shocks can always come along.

What we have been trying to stress in recent weeks—I did an interview for *The Times* back in August; Andrew gave his speech last Friday—is that we can step up the pace of QE significantly. We have slowed the pace to £4.5 billion or so a week. Back in March, when we were going big and fast, we were doing £13 billion of purchases a week, which is by far the fastest ever. That had the effect of dealing with the financial market disruption, which otherwise could have had an impact on the real economy and affected lending. I wanted to reinforce that short-term point.

In the long term, as Andrew was suggesting, the Brexit deal that we get will come more to the fore in terms of its long-term impact. All the analysis that the Treasury and the Government Economic Service have done for the Government, and that independent analysts have done, suggests that the impact of changes in trading relationships really comes through in the long term; it builds up incrementally.

That is where, for example, you would see more significant differences between a free trade agreement of the kind that we have assumed in our central case and if we fell back on orderly WTO terms and what that might mean. Those would have much longer-term impacts, but equally, they might be offset by a repositioning of our trading arrangements, because obviously you have to take account of new trade deals that could be done through us not being part of the EU.

Q952 **Rushanara Ali:** So you could envisage a situation, in a worst-case scenario, with a second wave and a no-deal Brexit, where QE could be significantly higher than what has gone on before, per week.

Sir Dave Ramsden: Let me just give you the timeline. Back in March, we were doing £13.5 billion of purchases—£13 billion or so a week. We slowed that to just under £7 billion back in June and July, and then we slowed it again to £4.5 billion in August, as Andrew was saying, to complete the current programme by the end of the year. We have headroom to do materially more QE if we need to add to it, and also we have the operational and other capabilities to do it fast, if market dysfunction required that. We can influence both the size and the pace.

Rushanara Ali: Thank you very much.

Chair: Thank you, Rushanara. We will now go to Julie.

Q953 **Julie Marson:** Governor, we have talked about household consumption. Could you please paint us a picture of what you have seen in business investment?

Andrew Bailey: As I alluded to earlier, it is weak by comparison. The evidence that we have from our agents, from the surveys we do and from the so-called decision maker panel is that it has not changed much. The message that firms are giving us on investment is that their investment intentions remain weak.

Sadly, I do not find that surprising. We know from history and economic theory that there is a strong relationship between the level of uncertainty faced by firms, the certainty of the economic outlook and the impact on investment. It is therefore unsurprising, given, as we said before, that we have calibrated in the monetary policy report fan charts a record level of uncertainty for the past 25 years. That is therefore having a negative effect on investments. It will be quite some time before that is unwound.

The other point I would make is that, given the uneven impact of that, one would expect uneven patterns of investment going forward. In some sectors—such as online retailing, if you have such an expansion in online retailing—it is not surprising to see an investment, so you may see quite an uneven pattern in investment.

Q954 **Julie Marson:** It is interesting when you talk about uneven patterns. Could you expand on some of the other sectors that might invest more or have a more positive outlook in terms of investment and those that might have a less confident outlook?

Andrew Bailey: I can only relate it back to those sectors that appear to be recovering more rapidly. I made a point about delayable consumption being quite strong from quite early in the period of restrictions. That translated through, as things got lifted, to some sectors of the economy where, again, purchases were strong. Obviously, in the housing market we are currently seeing strong activity. But, again, I think there will be uncertainty in the housing market as to what extent that is a bringing forward of activity through the stamp duty issue and an unblocking of a pipeline that was there before but got blocked during the restrictions.

We have seen quite strong activity in car sales. Delayable areas, such as home improvements, seem to be active. When we and our agents talk to people in the economy, if they are in areas such as art and entertainment, and in some areas of retailing and restaurants, sadly they are probably not going to be thinking about investment at the moment.

Q955 **Julie Marson:** Would anyone else like to add anything on that subject? If not, then perhaps I can move on to debt. We laud and praise, rightly, the success of the Chancellor's schemes for providing debt support to those companies to get us through this crisis. Andrew, to what extent will that be a longer-term problem, particularly with smaller companies struggling to pay that off before they even get to the point where they might think about investing?

Andrew Bailey: I think it is true that many companies will come through this with higher levels of debt than they expected. Some, however, will not find that so much of an issue, not least because the level of cash deposits by companies in the banking system has been high, and they may find that they have cash balances.

Interestingly, the level of cash balances of the corporate sector has gone up during the restrictions. Some of this, we find, may be precautionary borrowing, or precautionary use of the schemes, which people then pay down quite quickly because they got through it, as it were. For some, but probably for the medium to large end, there is a genuine question in my mind about the extent to which the market will need to enable equity provision, because otherwise we will have some elements of the corporate sector that will be over-indebted.

I should say, to make an FPC point here, that we were worried about over-indebtedness and leverage in some parts of the corporate sector prior to Covid, so I think there is a question about equity finance. I am keen that the markets and the financial market should enable the provision of equity. I am actually pleased that equity provision has been available for some firms during this shock, notwithstanding the severity of it. For others, I think that yes, there will have to be quite a delicate work-out process to get debt levels lower. I know that, again, this is something that both the banks and the Government are very focused on.

I would say this, wouldn't I, but going back to some of the sort of painful discussions I have had with the Committee in my previous life, it is absolutely critical at this point to avoid some of the problems that we have had in the past and that there is a clear—what I might call—"understanding" of the rules of engagement for working through this between borrowers and lenders, with Government involvement as well. I know that process is underway. It is critical because what we do not want is a repeat of some of the really unfortunate and difficult things that we have seen in the past.

Q956 **Julie Marson:** I would like to widen this out, if possible. Does anyone else have anything to add to what Andrew has said? I was wondering whether there are zombie companies out there that we either do or do not know about. That will have a profound effect on certain sectors or on the economy in general. Sir Dave?

Sir Dave Ramsden: There has actually been an ongoing debate since the last financial crisis as to whether there were lots of zombie companies being supported. Most of the analysis suggests that what led to the weakness of productivity growth after the last crisis, for example, was that it was a much broader range of factors. I think that this time around we really need to distinguish between the interventions that were absolutely necessary to bridge the UK through an extraordinary recessionary period where we saw growth plummeting day by day, week by week, month by month, through March and into April, and the kinds of recovery phases since.

To really reinforce what Andrew was just saying, yes, some companies will now have taken on more debt, but that was absolutely necessary to bridge them through that period. Not all of them will be viable going forward, and that is why, as we enter the next phase of the recovery, in terms of the kinds of interventions Andrew mentioned, we need to move away from thinking about economy-wide measures to measures that might be more targeted—we have already seen the Government doing that with the "eat out to help out" scheme and other interventions—and equally, in that phase, as we move, for large and small companies, away from the initial recovery phase, we need to try to emphasise the importance of equity alongside debt.

That goes back to what Andrew, I and others have been saying about the work of the financial markets. Because they are orderly at present and financial conditions are supportive, companies are able to raise equity, and again, that is very different relative to the global financial crisis, say, where financial markets were in turmoil for much longer.

We need to recognise the conditions as we see them in each stage of the recovery, and then work across the authorities, particularly looking to private equity markets to carry on, and looking at fund managers and the investment management industry, because there are ideas about how they might be able to create new funds to encourage investment. There is a whole range of approaches needed, but unfortunately there will be an adjustment where some companies will go under and others will have taken on too much debt and, given the kind of shock we have had, it will not be a situation where every business can work through this.

Julie Marson: Thank you very much. Chair, my time is up, thank you.

Chair: Thank you, Julie. I will go now to Siobhain, please.

Siobhain McDonagh: I want to look at the issue of mortgages. I am particularly concerned about first-time buyers being squeezed out of accessing mortgages due to high interest rates and large deposits required. I am sorry about this; I have just lost my page with my questions. Gosh, I am sorry about this. I had it all ready.

Q957 **Chair:** That's all right. I see that Colette would like to come in, so why don't we go to Colette? That will give you a moment to get your papers together.

Dame Colette Bowe: Just while Siobhain is putting her notes together, I wanted to add a thought to what Dave Ramsden was saying about equity finance a few moments ago. It is quite a big area of focus for the FPC in the next bit of time, and the important question for us will be small and medium-sized enterprises and equity finance: is it available, and do they want it? That is going to be an important area of focus for us. I make the point about "Do they want it?", because many people sitting around the Committee table will know that entrepreneurial small businesspeople do not always want other people coming in and taking equity in their businesses, but that might be just what their business needs. We need to have a rather important national conversation about this. It is a very long-running issue for this country, and the FPC would like to make a bit of progress on it.

Chair: That is helpful. Siobhain, are you ready?

Q958 **Siobhain McDonagh:** I am fine now, thank you. We have had quite extensive reports that, due to the stamp duty reduction, mortgage brokers have been swamped with demands from borrowers and that they are unable to keep up with it. As a result, they are increasing interest rates, particularly to first-time buyers. Are you concerned that the cut in the base rate has not been passed on to sections of the mortgage market? I would like to ask Dr Jan to answer.

Dr Vlieghe: One of the things we have seen, and I think this is what you are referring to, is a widening in the gap between the interest rate charged on a 75% LTV mortgage, a mortgage for which you have a very high deposit, relative to the interest rate charged on a mortgage for which you have a much lower deposit. To some extent, that gap had narrowed over the past few years, and it has just gone back to levels that prevailed a few years ago. It is true that that means there is not as much stimulus from lower interest rates as would have been the case if all these mortgage rates had fallen by the same amount, but it is also important to point out that a mortgage with a much lower deposit is a much riskier loan for a bank to make, so it is right that there should be a higher interest rate attached to it. It is not really for us to say how much higher, relative to interest rates with a higher deposit. Economic circumstances have changed drastically over the last few months. There is now the prospect of a significant rise in unemployment, which previously was not there, which also makes these products riskier, so you would expect some adjustment in the risk price.

I also draw an analogy with what is happening with lending not only by banks but by financial markets to the corporate sector, where you have a seen a widening of the gap in the interest rate that is charged to highly leveraged companies relative to the interest rate charged to companies that are less leveraged. You would entirely expect, when the economy weakens and prospects become both worse and riskier, that there should be an adjustment of these loan rates.

Q959 **Siobhain McDonagh:** Except that when you deal with the housing market, you deal with people's basic need to have somewhere to live. If we are actually squeezing first-time buyers out of the system in favour of buy-to-let landlords, does that not have a wider social consequence that you should be minded to consider?

Dr Vlieghe: There might indeed be social priorities that people would attach to who you want to own houses, but that is absolutely not a monetary policy issue. If you think that certain sections of the population should get subsidies so that they can afford to live in their own house when the market price does not allow them to do that, that is a matter for Government, not the central bank.

Siobhain McDonagh: I would argue, though, that the housing market is pretty broken anyway, certainly in London and the south-east.

Chair: Andrew had his hand up. Do you want to come in?

Andrew Bailey: I want to add a brief point to underline what Jan was saying. It is clear, as we saw this morning, that the rate of activity in the housing market and the mortgage market as a whole is very strong. However, you are right— By the way, I think that all the evidence we have is that the cuts we made in the official rate have been broadly passed through.

However, what has happened—this reinforces Jan's point about high LTV mortgages and the risks; unfortunately, I am going to use a cricketing analogy at this point—you get what is called a batting average effect. In other words, there has been a withdrawal of what I would call the cheaper high-LTV products from the market, and the batting average effect means that the average cost of a high-LTV mortgage therefore goes up. That does not mean to say that any individual lender has not necessarily passed through a cut, but that, on average, the cost of a high-LTV mortgage has gone up, because there has been a withdrawal of products that were at the lower cost end for, let us say, a 90% LTV mortgage bracket, which increases the average cost of a high-LTV mortgage.

That is entirely consistent with what Jan was saying, and I am afraid that it is entirely consistent with having gone through a period in which obviously there was uncertainty around the pattern of house prices. To date, we have seen an initial dip in house prices, but on the latest evidence that has been more than recovered. The final thing I will say is that there is still probably some uncertainty as to whether that effect was particularly brought on by stamp duty or whether it will persist.

Q960 **Siobhain McDonagh:** Thank you. There are reports that the information that lenders are demanding is like nothing that has been seen before. They are literally fine-tooth combing bank statements for anything that might be out of place. Are there checks, for the purposes of FPC mortgage controls?

Andrew Bailey: I didn't think I would be able to say this for a long time, but I think that is really more a question for the FCA, actually, because it is really a conduct question. The FPC's policy in the mortgage market is particularly directed at avoiding an over-concentration of borrowing with high loan-to-income ratios, because of the historical relationship that that has tended to have with mortgage defaults, downturns in the economy and a negative effect on consumption in the economy. I think your question is really about the conduct of mortgage lending and is for the FCA.

Q961 **Siobhain McDonagh:** Okay. The FPC appears to be taking a stance of encouraging lending. Are banks following this encouragement?

Andrew Bailey: I will start, and I am sure other members of the FPC will want to come in. Interestingly we have seen, particularly for corporates, very strong bank lending—historically strong bank lending. Now, we have got to break that down into various parts. So in the initial part of the Covid period, before the Government schemes came in, we saw large corporates drawing heavily, particularly on their standby revolving credit facilities, which they have. If you look at the numbers for February and March, and particularly March, there was almost a record drawdown of corporate lines of credit.

Q962 **Siobhain McDonagh:** I am more interested in the whole mortgage side of things.

Andrew Bailey: Oh, the mortgage market. Well, obviously the mortgage market essentially froze; we went through a period where it just shut down. There was almost no activity. We are now in a period when the mortgage market has returned very strongly. As I say, on the latest data this morning looking at mortgage approvals, and then, when we look at the forward-looking indicators that we get from some of the commercial mortgage services—the online mortgage services—the pipeline of activity seems to be very strong. So at the moment, the mortgage market is one of the strongest areas, if not the strongest area, of recovery.

Q963 **Siobhain McDonagh:** Has the cut in stamp duty caused a mini-boom in borrowing that lenders do not have the capacity to deal with?

Andrew Bailey: I think it is hard at the moment to judge the impact of stamp duty—we will know that after the event—because, as I say, the other complicating factor in this is to what extent there was just pent-up demand in the pipeline that had got blocked back in March and April that has now come through. So I think we won't know the answer to that question.

I do not sense—although obviously it is something that is of great interest to both us and the FCA, I should say—that there has been a relaxation of lending standards. I mean, going back to the point that both Jan and I were making earlier, the evidence on the tightening of terms for high LTV lending suggests a bit of the opposite, actually.

Q964 **Siobhain McDonagh:** We are hearing of first-time buyers hanging on the phone to get through when the banks or building societies open, in an attempt to get a very restricted number of mortgage packages for themselves.

Andrew Bailey: I think that is right, because I think that the number of people at the moment who are seeking mortgage approvals is probably at quite record levels—obviously record levels possibly absolutely, but also relative to the capacity of the lenders to do the approvals. I think you are probably right, because what you have just said is consistent with the rate of mortgage approvals, which is very high.

Siobhain McDonagh: Okay. Thank you very much.

Chair: Thank you very much, Siobhain. My apologies that I was not more nimble-footed when you lost your papers. I should have made more—

Siobhain McDonagh: Oh, no. That is okay. That is my fault.

Chair: It was entirely my fault. Can we move now to Steve, please?

Q965 **Mr Baker:** Thank you, Chair, and as always I refer to my registered interest in Glint Pay, and I also apologise for being late to the session; I have been in the House of Commons.

Can I ask you first, Governor, some follow-up questions on a speech you made recently? In talking about headroom and QE, there seems to be a suggestion now that you want to unwind QE first and I wonder if that means that QE is now the Bank's preferred tool, or I wonder—I do not want to put words in your mouth, of course—if it is a necessary evil or the new normal to adjust reserves first before the interest rate. What is your view?

Andrew Bailey: No, it is not. I have put the question on the table. Bearing in mind that I was speaking—Jackson Hole was looking at the next decade. There is an established policy for the MPC and the Bank that a QE unwind programme would not begin until rates have gone up to 1.5%—I think that is the number.

There is a great logic to that. Don't get me wrong, because what that is essentially saying is that a high priority is to get to a position where—your point, actually—there is more scope to move interest rates both ways, because there is no question but that that would be a good thing for the MPC. There is a great logic to that.

Now, the question I pose is something like the following—I will give an observation for a moment. If you look at the interest rate curve at the moment, you don't get to 1.5% on the interest rate curve inside 10 years. So on current pricing, we would be in the current position for up to a decade.

Now, the question we pose is this. We have had two major shocks in just over a decade—the global financial crisis and Covid. The work that we did in the paper we published last Friday looked at the conditions under which QE may be more effective and to what extent QE is state-contingent. We went through the arguments and channels that QE works through, looking at signalling, portfolio reallocation and liquidity. Tentatively—obviously the number of case studies is not enough to be tremendously scientific—we think there is a state-contingent argument that QE has a more powerful effect, or that some of the channels of QE might work more powerfully, in these conditions of stress and market illiquidity. Personally, I do not think that is very surprising, but it is very interesting and very important because of what tools we use in particular situations.

Now, I am not going to be making a prediction here, but we have had a very deep crisis about once a decade. They are very different, but they are things that we have to deal with. We have used our toolkit impressively and actively and rightly. So the question is: what do we need to do as central banks to put ourselves in the position where we can use those tools most effectively? Does that call for, what we call in the paper, a countercyclical operation of the balance sheets in which we do seek to reduce the size of the balance sheet in the periods of upturn? Because both monetary policy and financial stability policy are countercyclical policies, in effect, so should we put ourselves in a position where we are more able to use the balance sheet and do QE in times of great need and great stress, when it appears to be highly effective? We put that as a question, because it is pretty leading edge in terms of thinking, but it is very important. I hope that gives you a picture of what lies behind the issue we put on the table.

Q966 **Mr Baker:** That is helpful, thank you. I want to pick up a couple of things. You mentioned that it could be 10 years to get back to 1.5%. I dare say that people in the meeting and many watching will remember when they used to get interest worth having on their savings. What are we to say to savers? When will savers get back to having interest worth having on their savings? What does that mean for a culture of thrift and saving?

Andrew Bailey: I am sure colleagues will want to come in—I can see Jan has his hand up—but the challenge is that pretty much globally we are living in a world of very low equilibrium interest rates. The reasons for that are to do with quite deep structural changes in economies—for instance, the ageing of the population with greatest savings. I think those are having profound effects on the equilibrium interest rate. Ten years ago, when low interest rates first emerged as we were dealing with the financial crisis, it was very reasonable, as the debate did at the time, to say, "Is this a cyclical phenomenon—a product of the depth of the recession that will go away—or is it more structural?" Today, much of the experience, the academic literature and the research done by central banks like the Bank of England suggest that it is structural. Now, this might seem like a counsel of doom to your question, but if we believe this, it does mean that we will have low equilibrium interest rates for a long time. I will stop there because I am sure—

Q967 **Mr Baker:** I want to bring in Dr Vlieghe, but I do want to push back on one point. When I look around at the culture we have in the country, looking at the streets and the data, there is not a lot of evidence that people have a low price on postponed consumption, as it were. Actually, people want to bring forward their consumption. There are, for example, an awful lot of big, fast cars out there funded by cheap credit. I am all for enjoying oneself in life—I like big, fast cars—but you have only got to look at the streets to see that people are buying cars on credit. I do not mind sharing with the public that we, in my household, recently bought a car with cash and the garage hardly knew what to say to us when we said we wanted to buy a car for cash—nobody does that anymore; they buy them on credit. Where is the evidence that there is any kind of culture in society of having a low value on postponed consumption? I just don't see it. I see people having a huge demand for debt—and it's cheap, and so they can have it.

Andrew Bailey: Well, it is true, of course, that they probably didn't like you turning up with cash because they make more money by lending you money than selling you a car.

Q968 **Mr Baker:** But this is madness, isn't it?

Andrew Bailey: Hang on, let me answer. This is not a problem that monetary policy can solve. The question that underpins monetary policy is the one I said before, which is we are now living in a world of very low structural real interest rates. We are also living in a world of low inflation. The challenge we have, which was not the one—and I was closely involved in setting up the MPC in the 1990s: if you had said to the people who were setting it up, who were on the MPC originally, "You know what, the challenge you are going to have is getting inflation up to target, not getting it to stay down at target," they would have looked at you and said, "Really?"

Q969 **Mr Baker:** Can we bring in Dr Vlieghe—would you mind? I have just realised I have only got three minutes left.

Dr Vlieghe: First, I want to answer your first question very directly. QE is not the preferred tool. QE is in most circumstances the tool you use when you have exhausted your interest rate tool. I certainly don't think about that any differently and I don't think the rest of the Committee thinks about that any differently. What is important about QE, when you think about how well it works, is the power of QE is state-contingent. That is a rather jargonish way of saying in certain circumstances it works very well; in certain circumstances it doesn't do very much. One of the things that the Governor highlighted is that some of those circumstances where it works very well are, for example, the circumstances that we faced earlier this year, when there was substantial disruption in the Government bond market, not just in the UK but internationally. That is when QE is particularly powerful. But in other circumstances, such as when markets are functioning well but long-term rates are already very low, I would have much lower expectations of what additional QE can achieve. I think that the key insight is that there isn't some fixed multiplier from QE to the rest of the economy, or to inflation. It depends on the circumstances.

The last thing I want to say is, the really important part, when you think about sequencing and do you unwind the QE first, or do you raise rates first—I previously made this point—as long as markets are functioning reasonably well, you can probably unwind at least part of the balance sheet without affecting the economy very much. The key is that you want to avoid sending an inadvertent signal about what you are going to do with interest rates by unwinding the balance sheet. So before we think about when we are going to do this, and in what sequence we are going to do this, a key requirement is that we should be very clear about what we intend to do with interest rates; because sending an inadvertent signal is what causes a lot of disruption. That is what happened in 2013 in the US. I am going back to being very clear about this.

Mr Baker: I am sorry to cut you off but I have at that point run out of time. I am very happy to hear you say that. I am very interested in the economic theory of expectations and big players, and I think we are emerging on to common ground where we all understand that there can be a great deal of disruption—I would call it herding—if things go wrong; but I am so sorry we can't explore that. I have run out of time.

Chair: Thank you, Steve. Mike, please.

Q970 **Mike Hill:** Thank you, Chair. My questions are around probing the EU decision not to assess UK equivalence in investment banking. We note that the financial stability report states that "The UK's equivalence assessment process is complete." So can we take it from this that the UK regulators have found the EU regulators and regulations as equivalent, and that this has been communicated to the EU? I don't know who is going to answer that.

Andrew Bailey: I will start, but I am sure colleagues will want to come in. It is true that we have done the assessments that we had to do on the leg of the whole thing whereby we have to assess whether the EU is equivalent. The conclusion, by the way, is one for the Government to make, not for us to make. The question of when that decision is made, and what it is, is actually one for the Government.

Can I come back to the first part of what you said, which is very important? Can I first say that contrary to some of the things that were said over the summer, the UK has submitted everything that was requested of it by the EU as part of the equivalence process. Some of the requests came in a bit later than others, so the deadlines were a bit moveable at times, but everything has been sent in.

You are right to say that article 47, if I remember rightly, of MiFIR has been taken out of the equivalence process by the European Union—for the moment, at least. This is important; let me make two points about this. One is that article 47 of MiFIR is, as you said, essentially the investment banking services part of it. If you look across the landscape of equivalence, at where the value of equivalence is in terms of activity in financial markets, it is interesting—I will use my words carefully here—that the largest amount of value is in article 47 equivalence.

The second thing to say is this: we understand that the European Union is looking at whether it wants to revise parts of MiFIR in the light of Covid. It is discussed quite openly in some circles that there will be lessons from Covid that will cause it to look at some of the investment services provisions and regulations. I think that is very sensible, personally, for the reason that I do not think any of us would regard our regulatory rulebooks as fixed for all time. Of course, the world changes: we learn things, things change, and we adapt to the changes that go on around us.

However, here is the really important point: I just do not see how we can have an equivalence process where the EU essentially says, "We're not even going to judge equivalence at the moment, because our rules are going to change." What does that mean, really? It means that they think this is a rule-taking process, whereby they will change their rules, ring us up to tell us what they are, and then say, "Of course, if you want to be equivalent, you had better adopt the changes to the rules that we have made." I do not think that is equivalence. Equivalence is about outcomes, it is about standards, and it is a much broader judgment. I am very concerned that if that is how they think equivalence works, we have not made any progress in this debate at the moment. We have said a lot about rule-taking in the past—the difficulty and dangers of it—and now we seem to have some evidence that it may be taking effect.

Q971 **Mike Hill:** That goes a long way to answering my second question.

Andrew Bailey: Sorry for the sermon.

Mike Hill: Under article 47, there are about 40 provisions, nine of which the EU are considering not looking at. I was going to ask you why you thought that was the case, and I think you have answered that, or started to answer it. Has anybody else got an opinion on that?

Alex Brazier: To reinforce what Andrew said, it shows the real danger for financial stability of having a textual equivalence regime that can be withdrawn at any minute on the basis of a very precise reading of rule-taking. We have a financial centre that is about 10 times the size of our economy; in other European countries, I think the biggest other centre—excluding Luxembourg—is about five times GDP, so we need the highest standards of resilience in our financial system here. You only have to look back to the financial crisis to see how that "10 times GDP" system could bring the economy to its knees.

The danger of an equivalence regime where you have to be precisely, textually equivalent is that you cannot set the standards you need for your financial centre, to protect your economy. At the same time, you cannot have the flexibility and proportionality in designing the rules to make them well-tailored to your financial system, so you maybe end up with not enough resilience and with inefficient levels of resilience. For all those reasons, the precise, textual version of equivalence is not great for either activity and competitiveness or financial stability.

Q972 **Mike Hill:** This is fabulous, because you have just answered my third question. It's amazing. Broadly speaking, the third question was "What are the financial stability consequences of there being no EU-side equivalence decision on article 47 banking services?" and you have just entered into that territory. Does anybody else have anything to say on that subject? Will we lose stability? I think you have answered that.

Alex Brazier: The danger of a textual equivalence regime is that you cannot necessarily keep up with a changing system and keep the rules well-tailored to that system, in the way Andrew described at the beginning, and in that sense it is a risk to stability. The flipside, of course, is that not that much business in London and the United Kingdom's financial centre actually depends on equivalence. There is about £300 billion-worth of revenue. About £30 billion of that comes from EU clients. Less than a third of that is at play when it comes to equivalence, so there are trade-offs here between business going on and the financial stability risks. I think it is pretty stark.

Q973 **Mike Hill:** So what you are saying is that the economic consequences for the UK of there being no equivalence decision by the EU on investment banking would be negligible. Is that what you are saying?

Alex Brazier: As far as we can tell from talking to the firms we have supervised now, yes, they would not be very large, whereas the other issues we are talking about—financial stability risk and inefficient regulation of our financial system—could be much bigger issues.

Q974 **Mike Hill:** Following on from that, if the EU is refusing to carry out some of its equivalence decisions, does the UK have any bargaining power on not finalising decisions and barring EU firms from selling services into the UK? Is that something that we would have in our armoury?

Andrew Bailey: Obviously that is a decision for the Government, not for the Bank of England. Alex is absolutely right in the way he has described the financial consequences of this. However, I would say that well-regulated, open markets are much the best outcome. Despite what we have said about to what extent equivalence matters in a financial sense, I am still a strong supporter of equivalence, because it means that we have open markets that are well regulated and that people can do business where they want to do business. That will be better all round. This is still something worth having, but it is not worth having on any terms.

Q975 **Mike Hill:** Going back to the politics—because you have been excellent in anticipating all my questions, the final one is the political one—in your opinion, Governor of the Bank of England, is choosing not to carry out these assessments not a breach of the political declaration accompanying the withdrawal agreement?

Andrew Bailey: That is a really interesting question. As we are not conducting that part of the process, we are not really the best people to answer that question. As I understand it—we are a bit more on to the point that I made earlier—given that the EU is at the start of a process to revise MiFIR, it wants to delay the equivalence decision or process. You make an interesting point about the text of the political agreement, which I am really not placed to answer because we were not parties to it. I would just reiterate the broader point that, if that is the way the process is heading, it suggests a very different view of equivalence to the one that I think is best.

Q976 **Mike Hill:** Thank you. Dame Colette, were you waving?

Dame Colette Bowe: No, I wasn't waving. Had I been, it would have been to agree with everything the Governor has just said.

Mike Hill: Thank you. That is the end of my questions.

Chair: We'll now go to Alison, please.

Q977 **Alison Thewliss:** Thank you. I want to ask some questions about macroprudential policy tools and whether they are fit to meet the challenges of economic recovery in a downturn. Some of my questions have been slightly touched on before, but perhaps we could expand on them. First, I want to ask about the five powers of direction at the FPC's disposal. Would it be fair to say that each tool is more about applying a brake to economic activity rather than accelerating activity?

Andrew Bailey: I will start, but I am sure Alex and others will want to come in. I don't think we quite see them in those terms. Of course, we are going through a very interesting real-life example of this at the moment. Let us take the cut in the countercyclical capital buffer that we made, the reason that we are not increasing it, as we were attempting to do when Covid hit, is that it is about preserving lending in a severe downturn. It is not so much about accelerating lending, or decelerating it, as about preserving lending, and preserving the capacity of the banking system to support activity.

So far, first, as Alex I think said earlier, the reverse stress test that we did for the August financial stability report—a very severe stress test, which Alex might want to say a bit more about—indicates that the banks have the capacity to do that in very adverse situations. Secondly, as we were saying earlier when talking about the flow of lending, I am encouraged by the fact that the banks are lending in the current environment. Lending flows are not really an issue at the moment in the banking system.

Alex Brazier: I will add one thing, if I may. Lots of those tools you implement before the downturn, but they put you in a much better position to deal with the downturn. Andrew has just talked about bank capital. I go back to the point that I made earlier: had we now been in the position that we were in with the banking system in 2007, the economic shock we have had means that we would have been in a full-blown banking crisis. We would not be talking about an expansion of credit to companies and families who need it to bridge through this; we would be talking about a massive contraction of credit supply and how to deal with that.

The fact that we put in place the measures before this, through stress testing and the build-up of capital buffers, means that we are in a completely different position. As Andrew said, banks are now able to draw down those capital buffers to absorb the losses that they will make because of this economic shock. As a result, they can maintain the lending that they have done; they do not need to cut back and to adopt a defensive crouch as they did back in 2008.

That has been the essential foundation for everything else that has gone on. The lending schemes, whether bounce back loans or business interruption loans, would not have had much value if the banking system through which they are being channelled was actually on its knees, like it was 10 years ago. The macroprudential measures that we have had in place put us in a much better position for the financial system to support the economy, to give it the support it needs through this. To use the car analogy that keeps coming up in this session, they might look like brakes to be applied in the run-up, but actually they put you in a much better position during the shock to give you the resilience that the system needs to be able to draw on to keep lending and supporting the rest of the economy. So far, on that measure, the performance of the system has been a complete transformation from where it was about 15 years ago.

Q978 **Alison Thewliss:** Okay. Do you have evidence to support an increase in lending being attributed to reducing the countercyclical buffer?

Alex Brazier: Yes. We talk to the banks very directly. Their big concern before was that we had made them build up these buffers of capital, but that they would not be able to draw them down as they took the losses, so they would need to take other defensive actions and cut back on lending. We have shown a willingness—a couple of times now—in the face of an economic shock, or a prospective one, to release that buffer, which sends a very powerful signal to the banks that it is okay to run down their capital buffers. We are completely serene about that. That is why the capital is there. It is there to absorb losses so that they can carry on lending.

That is why, in recent financial stability reports, our message to banks has been, "Look, you are going to take losses, because of the economic shock. Your capital will be drawn down—that is exactly what it is for. You don't need to go into defence." As a result, they have been rolling over existing loans and they have been expanding credit supply—as Andrew said earlier, hugely in the early months, and latterly through the Government schemes—in a way that no one could have envisaged in the last recession, or even in recessions before that. I think the lending numbers speak for themselves in terms of the way in which the banking system has been transformed over the past 15 or so years.

Chair: Andrew and Dave have their hands up—Dame Colette as well. Let us go to Andrew first.

Andrew Bailey: All this has happened at a time when banks have had to make additional provisions. They are having to provision quite aggressively under the financial reporting standards. It has been critical, notwithstanding the need for banks to increase their provision against expensive loan-losses, that they have been able to support lending, as Alex said. So far, it has worked.

Sir Dave Ramsden: I just want to make two points to reinforce what Alex was just saying. First, as well as stressing that the banks can use their buffers, and that the buffers are there to be used for just this kind of situation—they have built up capital buffers so that overall capital is three times higher than it was in the run-up to the last crisis—we have also emphasised that it is in their collective interest that they should all lend, rather than one individual bank thinking that it can go down a different route. That supports the overall macro economy, and over time means that the credit losses that they make will be less because the economic downturn will be ameliorated and the recovery will be stronger.

My second point is just to summarise what Alex and Andrew have been stressing throughout the hearing. What is really striking about this crisis and its recovery phase is that banks are part of the solution. They were the problem in the financial crisis. They exacerbated a real economic downturn and they meant that the recovery was more prolonged and it took longer to get back to close to where we started.

This time, banks are playing their part as part of the solution and it is important that we, through all our analytical exercises, reverse stress tests and everything else, support them in doing that. We have to recognise, however, that they do not have infinite capacity—capital could be exhausted if you have shock after shock—but from where we are so far, we are confident of the resilience of the system and that they can continue to be part of the solution.

Chair: Colette, I think you wanted to come in.

Dame Colette Bowe: My point is really a version of what Dave has just said. This is about the system. What the FPC does is aim to ensure the financial stability of the system. To go back to the question, which was couched in terms of brakes, that is not really the right analogy. What we aim to do is ensure that the financial system can deliver for the real economy. That is what our objective is.

Q979 **Alison Thewliss:** Can I pick up on Colette's earlier point about equity finance? Do you think there is a particular area where equity finance would be most useful? Is it about finance for highly leveraged companies, new companies, growth, balance sheets or all of those? Do you have a particular priority?

Dame Colette Bowe: I will kick off on that, Alison. As my colleagues know, I am particularly interested in equity finance for small and medium-sized businesses. As you will know, there are various issues in the supply of equity finance to those businesses, which I think we have to tackle. For example, why do pension funds not invest more in those longer-term, initially illiquid investments? What is stopping them? Is there a reason?

Now, there may well be things that we have to understand and unpick to address that problem. For what it is worth, I think we have to focus on the small and medium-sized businesses which find it extremely difficult to get into those sources of longer-term finance—what people used to call "patient finance", although they do not anymore.

Q980 **Alison Thewliss:** Does anybody else want to come in on that? I think I am just about out of time.

Alex Brazier: Can I just add one quick point then? To your question about who needs it, I think there are probably three sources of need for greater equity finance. All of that, by the way, is probably, or largely, in the unlisted sector, so people who do not have access to the public capital markets. It is great that they are open, but that is why it is going to rely, as Colette says, on insurance companies, pension funds, and investment funds of all sorts, and why in the financial stability report we set out our initial thoughts on possible reforms in those areas that might increase the demand for equity. The number involved—the assets under management—is £5.2 trillion in those things, so a small movement of the needle on the dial can actually make a big difference to the supply of equity of unlisted types across the economy.

Alison Thewliss: Okay. Thank you.

Chair: Finally, to Anthony.

Q981 **Anthony Browne:** Thank you, Chair. I should declare—it is obviously a matter of public record—that I used to be the chief executive of the British Bankers' Association and worked on many of these issues with the FCA and the Bank of England. The questions I will ask about the stability of the system and how the banks have responded to the crisis have been touched on a bit. I just want to pick up on a couple of points.

You mentioned earlier that the banks went into this with three times the amount of capital that they had before the global financial crisis. Do you know what impact the crisis has had so far on their capital ratios? Is there an estimate of that? I do not know whether this question is for Alex or Andrew.

Alex Brazier: I will start. Reported capital ratios have actually risen by half a percentage point. For the major banks, their common equity tier 1 ratio has risen from about 14.5% to about 15%. That is actually because their underlying profits and, importantly, the retention of what would have been a dividend distribution have allowed them to boost their capital position. When we look at the possible losses that they could take in the sorts of scenarios in the fan charts, in the central case, on prudent assumptions, you are looking at credit losses of the order of around about £60 billion—that is not actually far off what their market valuations actually imply; do not take our word for it, the markets think the same—which is a fall in capital ratios of around 2.5 points, so from around 15.5 down to around 13.

That is in complete contrast with where we would have been back in 2007. I cannot emphasise that enough. That drawdown of capital would have basically wiped out the capital of the banking system. We are looking, in the central case at least, at a small use of capital buffers. It would take a doubling, really, of the severity of the scenario to use up a reasonable proportion of banks' available capital buffers, which is why, as Dave said a moment ago, we have been able to conclude that banks will actually be resilient not only in the central case but in a very wide range of potential economic outcomes embodied in that very wide fan chart that we started our discussion off with earlier on.

Q982 **Anthony Browne:** You touched on possible credit losses and the provision made for them. Have you done estimates yourself of the possible credit losses for the industry? There are huge amounts of lending, some of which is guaranteed by the Government, obviously—the bounce back loans—but the banks do not know quite how they will realise that guarantee, and then there are CBILS, which are only partially guaranteed by the Government.

Alex Brazier: Back in May, we looked at an economic scenario that actually, overall, was a bit more severe than the latest central projection in the monetary policy report. On relatively prudent assumptions, we calculated overall credit losses—not only on the new loans, which are a very small fraction of banks' books, but on their existing books—of around £80 billion. The fact that the central outlook is modestly better than it was back then means that we are in the ballpark, on prudent assumptions, as I say, of around £60 billion. They have already made provision for around £20 billion in the first couple of quarters, and it remains to be seen how that plays out, but even £60 billion is a small dent in banks' capital buffers, which were built up for this very reason.

Q983 **Anthony Browne:** That is it. I will come back to the discussion point earlier about the impact of ending the transition period with the EU without a new deal. You implied that that would have limited impact and is well within the stability of the banks to withstand that, so you have no concern about the range of future shocks that there could possibly be?

Alex Brazier: No. As is well known, we looked at some particularly bad, disruptive scenarios for the end of the Brexit transition period. I think our latest word on those was in a letter to your predecessor Committee in September 2019. Those sorts of scenarios are pretty bad, with lots of disruption. As Andrew said earlier, you cannot disrupt trade twice, so they are definitely a worst case in the current circumstances. We were looking at a shock that depleted—across the system, as Colette said earlier—capital ratios by around 1 or 1.5 points, which is well within the margins that we are looking at here, hence why we were able to conclude in the financial stability report that not only could the system deal with a much more severe period of economic disruption arising from the virus but, on top of that, could deal with some disruption to trade and activity resulting from the end of the transition period.

Q984 **Anthony Browne:** I want to turn to the issue of competitiveness—this is obviously an old issue that we have been looking at as a country for 20 years or so—and the impact on the prudential regulation. The Treasury issued a policy statement update in June where they said they would put more emphasis on international competitiveness in the financial services Bill. Do you have particular concerns about that and the impact it might have on prudential regulation? I am looking at Andrew here, as you hold overall responsibility for bringing the parts together.

Andrew Bailey: I think we have to be very careful about how we define the meaning of this. In the prudential world, much of the framework that we operate under, particularly the microprudential framework, is defined by international standards, particularly by the Basel committee. It is very important that that is the case. That is a crucial foundation that has been reinforced post financial crisis by the work of the Financial Stability Board. It is crucial that there is no element of what I might call competitiveness in anybody’s thinking that they can get ahead of another one in terms of the operation and creation of those international standards. One of the great strengths of the system post financial crisis is that we have had a truly global response and it has not led to an outbreak of competitiveness.

Given that, in the prudential world, it is always sensible to ask the question: what are the effects of that system? What are the effects of the way it operates in any particular jurisdiction? Is it having unexpected effects? I don’t have any problem with that, and I don’t have any problem with carefully applying the word competitiveness in that respect. I don’t have difficulty with the way it is couched in those terms, but I want to emphasise that we have to have a robust underpinning of standards, which I believe we have achieved post financial crisis. As Alex was just saying, very eloquently, that has been hugely to the benefit of the system in the crisis we have been in.

Q985 **Anthony Browne:** I have one last question. We have covered a huge range of areas, but throughout this whole crisis we have been through, are there any particular lessons learned from the Bank of England’s point of view?

Andrew Bailey: Yes, indeed. Going back to the questions that Mr Baker was asking, the paper we released on Friday in the area of monetary policy tools was very much drawing on lessons of the crisis so far—I have to emphasise “so far”, because I wish we could say we were definitively on the other side, but I don’t think we can. That is one big lesson that Alex has mentioned in respect of the banking system, but there is one other big area, which time probably does not allow us to get much into, but which we have flagged a number of times and which I flagged on Friday.

Here is the other big area of work that we are doing, but we are doing this internationally. In many ways, the threats to financial stability that we saw in March were in the non-bank parts of the system and not the banking parts. We have described the “dash for cash” in the speech that Jon Cunliffe gave and the speech that Andrew Hauser, our executive director for markets, gave. We have been major proponents of the work that the Financial Stability Board is now doing on this, because we think it raises very big questions for both financial stability and monetary policy. It raises questions for financial stability in the sense that, yes, the post-financial crisis reforms have led to a very sensible rebalancing of activity, so that there has been a relative growth in the non-banking system versus the banking system. I don’t think that is a great surprise, given the experience of the crisis. However, we have to ask the question: are there elements of the non-bank system and weaknesses in the non-bank system that could in their own right have systemic effects throughout the system? Did we see those during March, for instance?

It is also true, and here is where monetary policy comes in, that we and other central banks such as the Federal Reserve, the ECB and others had to respond—as we were saying earlier, when I used the term “go big, go fast"—with very aggressive use of QE. That was done—Jan described this as well; it was a contingent point—because of the economy, but it was also initially done because we were having a meltdown in certain parts of the non-banking financial system and we had to respond. Therefore, this is the big question we have on our agenda, because we not only had to use the traditional tools of central banking, which put liquidity into the banking system, but had to go beyond that and use QE, which can go—to borrow from the Heineken advert—to "the parts other beers cannot reach". Of course a lot of central banks have to ask the question: is that the optimal system and the optimal response? These are very big questions.

Chair: Alex?

Alex Brazier: I want to develop Andrew's point. The big thing we saw in the non-bank system in March—the dash for cash, as Andrew describes it—was a big threat to financial stability. The cure, as Andrew says—go big, go fast asset purchases—was very effective. But the big question we are addressing now with international colleagues, because these markets are international, is: what preventive measures might be better than a repeated cure for the non-bank financial sector? Frankly, we had rising gilt yields from 0.2% to 0.8% in a week. That is not financial stability and it had nothing to do with gilt issuance. It had everything to do with the financial position of the people investing in those markets. Internationally now, we are looking quite seriously at prevention that might remove the need for such aggressive cures in future.

Q986 **Anthony Browne:** By which you mean regulation of the non-bank sector.

Alex Brazier: And various measures, yes. Our ideas about those are detailed at some length in the financial stability report around margin requirements, leveraged investors, money market funds and open-ended funds. There is quite a broad canvas. The interesting thing that happened in the markets in March was that lots of issues, some of which we had spotted, and vulnerabilities in markets actually came together and fed off each other to create this dash for cash that drove gilt yields and other bond yields up very sharply in a short period.

Q987 **Anthony Browne:** In a sense, it was inevitable that as you drove risk out of the banking sector, risk ended up elsewhere. Dave, you wanted to speak. I think that was the last question. We have run out of time.

Sir Dave Ramsden: Alex has said much of what I was going to say about the ongoing agenda for non-bank finance, but we are left with the position where, as Andrew said in his Jackson Hole speech on Friday, the Bank of England's balance sheet is now at about 40% of GDP and rising. We need to think through the implications of that and whether prevention in the private sector, as Alex has said, would not be some self-insurance alongside us playing that role.

The only other thing I was going to say, the other lesson we have learned—I say this with responsibility for a lot of the Bank's operational functions, and this takes us back to where we started this session—is that we have learned in the Bank of England that in a crisis we can run all our critical functions away from the office, whether that is in Threadneedle Street or our Moorgate offices. All the interventions we have made—the creation of the CCFF, the QE, and all the market activities to support the Bank's interventions—have all taken place from people's home offices. That is not necessarily sustainable. That is not where we want the new normal to be, but it does suggest more flexibility in how we run our key operations, and that is true of us and other parts of the financial sector. We have managed to run the risk assessment alongside those, because obviously you have to be very mindful of operational and cyber risks. Again, that takes us back to where we started, but I wanted to add that as a more prosaic lesson.

Anthony Browne: It is quite an extraordinary thought that people have been spending tens of billions of pounds from their home offices. As you say, that should not be the new normal. That is all for my questions. Thank you very much.

Chair: Thank you, Anthony. We are out of time, and that brings us to the end of this session. I thank all our panellists. As usual when we are Bank of England-facing in these sessions, we tend to have a very detailed, rich and insightful experience with you. I think I speak for the whole Committee when I say we have had exactly that today. Governor, you were very good at anticipating the questions. Our hope as a Committee is that you are all very good at anticipating the answers as we go forward. We thank you for the very hard work that I know you are all doing to keep the economy going as best as we possibly can under these difficult circumstances.