

Treasury Committee

Oral evidence: Re-appointment of Dr Gertjan Vlieghe to the Bank of England Monetary Policy Committee, HC 1056

Tuesday 22 May 2018

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Members present: Nicky Morgan (Chair); Rushanara Ali; Mr Simon Clarke; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Alison McGovern; John Mann; Wes Streeting.

Questions 1 - 27

Witness

I: Dr Gertjan Vlieghe, External Member, Monetary Policy Committee.

Written evidence from witnesses:

– [Dr Gertjan Vlieghe, External Member, Monetary Policy Committee.](#)

Examination of witness

Witnesses: Dr Gertjan Vlieghe.

Q1 **Chair:** Dr Vlieghe, good morning. Thank you very much indeed for being here before the Committee. I think you have a double dose of the Committee this morning, so we will see you on your own first and then later on with your colleagues from the MPC.

Just an open question to start with, looking back on your first term, perhaps you could set out some highs and some lows of your experiences and some particular personal contributions that you feel you have been able to make to the MPC decisions.

Dr Vlieghe: First of all, it has been a tremendous experience, which is why I was very keen to do it again for another three years. It is a privilege to do this job.

There have been lots of interesting developments since I joined the committee. There has been quite a remarkable turnaround in the balance of risks around global growth in both directions, which I have talked about. There has of course been the vote to leave the EU, which has had very interesting economic consequences and financial market consequences, things that have kept us busy in terms of analysing and continuously learning. I think those two have been the biggest developments over the past three years or two and a half years.

Q2 **Chair:** No, that is great. Your voting record suggests that you align fairly closely with the views of your fellow MPC members. What do you think are the most important differences between the MPC's collective outlook of the economy and your personal views?

Dr Vlieghe: At the moment, I don't think there is a big difference. I feel like I can associate myself pretty closely with central forecasts and have done. We have gone through this evolution of realising and acknowledging that global growth was better and was making a bigger contribution to the UK, but then at the same time, learning the extent to which the anticipatory effects of Brexit and the uncertainty around Brexit was having a dampening effect on various bits of the economy and a boosting effect on other bits. The balance of all those things, I have not had major disagreements with the rest of the committee.

Q3 **Chair:** Do you think there is too much collective agreement? Would you feel confident about disagreeing with fellow MPC members? Do you think that other members of the committee are prepared, should circumstances change, to voice disagreement?

Dr Vlieghe: I have, at least on one occasion, had a different vote from the rest of the committee, so I don't feel any need to agree with people just for the sake of agreeing. But I also think that it is useful to make the distinction between the fact that the votes have all been reasonably close, that does not necessarily mean everybody is on the same page



exactly. It is quite possible to have a different emphasis on different parts of the economy, but to still come to broadly the same policy conclusion. The fact is that we are in an environment right now where we think interest rates will go up very gradually over the next few years and that you can have quite different opinions about different forces in the economy that bring that about. It is not even the case that everyone comes to the same vote, but even if they did, it does not mean they all think exactly alike.

Q4 Chair: So there are quite vigorous discussions before you get to final decisions?

Dr Vlieghe: Absolutely. That is exactly the point.

Q5 Chair: In his remit letter to the MPC, the Chancellor says that co-ordination between the MPC and the Financial Policy Committee has, “enhanced the strength and resilience of the UK’s macroeconomic framework”. Your response in the questionnaire suggests that the co-ordination between the two committees is quite light touch and there is little spill-over between proposed actions at the moment. Are you content with the contact between the committees and that the remits are delivering the strong and resilient macroeconomic framework that the Chancellor talks about?

Dr Vlieghe: Yes, absolutely. I think the thing to keep in mind is that the two committees have different objectives, different tools and different expertise and it is not necessary and probably not useful for the same group of people to make all those decisions. It is very useful to split it in two. What is important is just for each committee to be aware of what the other committee is thinking about doing. I feel that communication works very well. We are very regularly briefed; we meet them. I also speak to some of the members individually and they also feel that they are well aware of how our thinking is evolving and what we are considering doing. I see no issue at all. It works very well.

Q6 Chair: Could you foresee a time when potentially the MPC might have to be more cognisant of financial stability when making decisions, so there might be less of a split and more of the MPC having to be more aware of the FPC’s remit?

Dr Vlieghe: Absolutely. Logically that is entirely possible. Indeed, I wrote about this in my letter. This is the reason why, in a period of forward guidance in 2013-14, there was an explicit provision that circumstances may arise where the MPC will have to have an eye on financial stability and therefore will have to move rates for other reasons than meeting the inflation target. Indeed, it is part of our remit. It is well-known that these circumstances might arise. It is just that during my time on the committee those circumstances have not arisen. We have been able to set monetary policy exclusively with an eye on meeting our inflation target and we have been able to leave the financial stability consideration to the FPC. But indeed, that could change.



Q7 **Chair:** You mentioned the voting in June 2016. I suspect we are not going to get very far this morning—in fact, we are definitely not—without discussing Brexit. Do you think that the challenge for the MPC in identifying a Brexit effect on the economy is anticipating what other people are going to do, rather than predicting the economic consequences of Brexit? I think you talk in the questionnaire about the effect on households and businesses and the decisions that they are taking. Does the MPC spend quite a lot of time trying to almost second-guess what people are going to do because of Brexit?

Dr Vlieghe: Yes. I am not sure I would use the word “second-guess”, but the framework that we use—and I have made this point publicly several times—and the reason why Brexit is important for the country is all to do with the long-run impact on the economy. The long-run impact on the economy is not the major concern for setting monetary policy today. It is mostly about the supply; it is mostly outside the horizon of today’s monetary policy.

The only bit that affects monetary policy today is how other people are reacting to the potential changes in the long run, so that means businesses, it means households, it means financial markets. We always knew that. We knew that when the vote happened that nothing would change and nothing would change for quite a while, but nevertheless, there might be changes in the economy. That is what we have been tracing through. For households, we have been analysing exactly how they are responding to potential future changes in income, but also current changes in income, because the exchange rate has affected inflation, which in turn has affected real income growth.

For businesses, we are looking to what extent uncertainty has been having a dampening effect on investment. To be sure, in the immediate aftermath of the vote, there was much less of a response than we thought, but now gradually that response is building. It is still less than we thought it would have been cumulatively, but there is a clear effect and we talk about this in the Inflation Report. We have surveys where we can split firms by those who say that Brexit is an important consideration for them and those who say that Brexit is not that important. You can see that for a while the firms for whom Brexit was an important consideration for their business had lower investment than firms for whom it was less important. We have some pretty clear-cut evidence that it is having an effect.

Chair: I am sure we are going to return to that later on. Stewart.

Q8 **Stewart Hosie:** Dr Vlieghe, in your response to the questionnaire, you said that the risks of MPC publishing its view on the future path of the bank rate were outweighed by the potential benefits. You highlighted a key benefit, that the MPC’s intentions will be more easily understood by everyone and not just Central Bank observers. Can you describe how you are concerned about the way that MPC currently communicates its expectations to the wider public?



Dr Vlieghe: I would like to back up just briefly, just to reiterate that the fundamental reason why we communicate a lot about our outlook for the economy, and therefore implicitly the outlook for interest rates, is because we think it helps monetary policy work better, because monetary policy is not just determined by the interest rate today, but by the expectations of the entire future path of interest rates and inflation. The MPC has always known that and so we have always worked hard ever since its creation to communicate as clearly as possible about this.

There has been an evolution in how we have thought about this, so we have gone through different phases, which I outlined in my answer, going from the constant rate forecast to a market rate forecast. Other central banks have also evolved and have gone even a step further, which is to publish their own forecasts for the path of interest rates. The point that I make is that I do not think there is something fundamentally wrong, I do not think we are missing out hugely with what we are doing, but I do think, having learned from these other experiences and having read the academic literature on this, it is likely that there is a small further benefit from going that extra step that I described.

One other point I want to make is a really big challenge that is not going to be solved by taking this step is that we constantly need to remind people that when we communicate about the economy, and whether directly about interest rates or not, we are giving people a probabilistic assessment, "The economy is uncertain". That is not the same thing as saying, "We do not know anything about it". We know a lot about it, we know it is much more likely to be in a certain region than in another region, but it is uncertain. As the data comes in, we constantly update our assessment, so that assessment changes slightly. The implicit path of interest rate also changes slightly.

People then say, "Oh, but before you said this was going to happen and now you said that was going to happen. How can it change?" It is always going to change. If we become more explicit of the path of interest rate, that path is going to change every quarter. Some people are going to continue to be disappointed by the fact that we said one thing and then we do another thing, but that is a fact of life in economic policy setting.

Q9 Stewart Hosie: That would, I presume, remove the kind of confusion that we had from the February minutes, where it said, "Were the economy to evolve broadly in line with the February Inflation Report projections, monetary policy would need to be tightened somewhat earlier than anticipated at the time of the November report". That would be removed by something that was slightly more explicit, but clearly allows people to understand underlying economic thinking that drove the rate to change assessment.

Dr Vlieghe: I was very happy with that communication because, broadly speaking, what it said is that market yields were implying two rate rises over three years in November. By February, we thought that was probably not enough, so we said it probably needs to be more than that.



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Then it was three, now it is still three. I do not think it is that confusing, but what happened over the last few months is that we thought the economy was going to evolve in a certain way and then the data in the first quarter was markedly weaker than what we expected and we had to make an assessment about whether that told us a lot about the medium-term outlook or only a little bit about the medium-term outlook.

We decided that it probably did not tell us very much, but just enough that May was not the right time to put interest rates up and we might put it up a little later. That is exactly an example of we will respond to the data and if the data are a little different from what we thought, then our interest rate plans are going to be executed slightly differently from what we thought earlier. That is not going to change by changing the communications.

Q10 Stewart Hosie: Sticking with communication though, the idea of the MPC being more explicit about the future path of the bank rate, is that something you are actively pursuing within the committee?

Dr Vlieghe: It is something that I have brought up a few times, that I think this would be a good thing, so we had a few conversations about it.

Q11 Stewart Hosie: Is that supported by other members or by bank staff?

Dr Vlieghe: There is a range of opinion. You can ask individual MPC members what they think about it. We have not gone around the table and taken a vote on this. It has come up a few times. I have made the point that I think this would be a useful thing to do. Some people have already stated clearly that they do not like it; some people have clearly stated that they do like it; other people still want to make up their minds, I think.

Q12 Stewart Hosie: Just finally on this, you also suggest in your response to the questionnaire that a possible disadvantage to being too specific about the expectations for future rates is it might be too difficult for the committee to agree on it. Does this suggest concerns within the MPC that future forecasts have the effect of restricting or chilling discussions?

Dr Vlieghe: This is an argument that people have traditionally brought up, not necessarily on the MPC, but in general in debates in other central banks also, that it is very straightforward to get a committee to vote on one decision today, but how do you vote on a sequence of decisions in the future? People say, "That will be too difficult, so let's not do that". But instead of thinking about it like a sequence of interest rate decisions in the future, I think about it just like we agree on a path for inflation and we agree on a path for GDP. It is a forecast. People will not be exactly in the same place, but it is a best collective judgment and people say, "That is close enough". If it is not close enough, then they can give a speech and say, "Mine is a little bit higher" or, "Mine is a little bit lower".

I do not see that as an impediment. The experience in the central banks who have gone this way have shown that it is not really an impediment,



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it can be overcome. But I am highlighting it because some people use this as an argument to say, "Look, this is going to be difficult to agree on". We have not tried, so we do not know, but other people have tried and they have said it is fine.

Q13 Charlie Elphicke: Morning, Doctor. Historically over the last 17 years—or two decades even—the UK has been among the fastest-growing economies in the G7. Do you see any structural change to this or do you think that trend is likely to continue?

Dr Vlieghe: I am sorry, what was the horizon you said, 17 or 70?

Charlie Elphicke: Over the last 17 years, over the last two decades, the UK economy has been growing at a good clip, among the leading economies in the G7. Do you see any structural change likely to this or do you think that trend is likely to be the case?

Dr Vlieghe: I am trying to understand, where does the 17 years come from?

Charlie Elphicke: It is over the last 17 years, over the last two decades, the UK economy has been among the fastest-growing in the G7, yes? Do you think that will change?

Dr Vlieghe: It has already changed. Sorry, the reason I am picking on the two decades is because it seems like an odd characterisation, because there was a massive break in the middle. We had an experience before the financial crisis and we have had an experience since the financial crisis. The experience before the financial crisis was that growth was very rapid, but it was accompanied by a rapid credit build-up, which was unsustainable. Afterwards, growth was very weak and we had an experience of deleveraging, which was healthy, but it did cost in growth terms.

In general, the UK did relatively well in the post-crisis period, I think because a lot of the policy actions were very decisive and early. We did QE, we did it early on and we did it aggressively. We worked on recapitalising the banking system early on and aggressively and that paid dividends. That is why even though all countries had a slowdown in relative terms, the UK did better. Much more recently, over the last year and a half or so, the UK has indeed fallen below the rest of the G7. I think that is circumstantial evidence for the effect of Brexit. It is not proof that Brexit is having that effect, but combined with all the other things we know about it.

We know that UK investment growth has dipped below the investment growth of the other countries and it has done that at a time when the global economy has strengthened, when traditionally you would expect the UK, which is a very open economy and well-integrated with the world economy, and if the global economy does well, the UK does well too. Instead, we have continued to slow, which has been disappointing. Where



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we go from here will depend very much on what sort of decisions are taken in relation to our future trading relationships with the EU.

- Q14 **Charlie Elphicke:** As we have mentioned Brexit, during the referendum the Treasury produced a document setting out the economic consequences if the country were to vote to leave the European Union. Do you think those predictions have been borne out?

Dr Vlieghe: What a lot of people analysed is the long-term consequences on the economy of various future relationships. It is far too early to judge that, because nothing has changed yet. We will have to have this meeting again in 10 or 15 years and look back and say, "Did that turn out?" If I were to characterise the short-term forecast that various people made around the time of the referendum, we were slightly on the pessimistic side, even though we were a little bit above the consensus, so we were less pessimistic than other people. There were some people who said nothing at all will happen. That turned out to be far too optimistic because of course things did happen. I think *The FT* recently showed an analysis that where the economy ended up was precisely halfway between the people who thought it would slow on average and the people who thought that nothing would happen.

- Q15 **Charlie Elphicke:** Turning to interest-rate setting, obviously you are a member of the MPC and you always vote with the majority. Why is it that you do not vote with Mr Saunders and his group to increase rates?

Dr Vlieghe: I do not always vote with the majority. I generally have voted with the majority, but not every time.

- Q16 **Charlie Elphicke:** According to this, since February 2017 you have voted with the majority.

Dr Vlieghe: Yes, but not during my entire time on the committee.

- Q17 **Charlie Elphicke:** Why is it you have been dovish on interest rates and why do you think Mr Saunders has been more hawkish?

Dr Vlieghe: We are going to hear from him in the next hour, so you can ask him. I have been of the view that it is right that circumstances are such that interest rates are probably going to go up in the next few years gradually. I voted to increase them in November and I thought and continued to think that they would probably go up again this year. The difficulty with deciding what to do in May was that even though I, like the rest of the MPC, thought it is probably mostly erratic and it probably does not tell us something about the medium-term outlook, since we are only putting interest rates up quite slowly, there is a very low cost to just waiting another few months in order to see indeed confirmation that what happened in the first quarter was erratic and that we have stronger growth in the second quarter.

On balance, I favoured just waiting and getting confirmation of that, rather than assuming that the rebound would happen and going ahead



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with the interest rate increase. But it was entirely obvious, the decision. My thinking evolved as the quarter progressed, initially thinking May seems like a reasonable time to go again and then quite late in the quarter, when the numbers came in, thinking maybe it is just better to wait a little bit.

- Q18 Charlie Elphicke:** Do you think there is an economic case that interest rates have been so low for so long that it is now producing a distorting effect on the British economy, in that there is no pressure to allocate capital to the highest efficiency and that that is causing a drag on productivity?

Dr Vlieghe: I do not think that is a useful way to think about interest rates. There has been research for some countries showing that maybe there is this—I think that what you are referring to—zombie effect of firms that are very unproductive, which with higher rates would not survive, but with low interest rates, they do survive. People who have looked at that for the UK have not found convincing evidence that that is happening here, but much more importantly, what you need to think about is not just what happens to that tail of weaker under-performing firms, but if we had put interest rates up earlier, then I think we would have had a weaker recovery, on average we would have had weaker inflation, a higher unemployment rate.

One of the key pieces of evidence that that is what would have happened is that we have seen lots of countries in this recovery, everybody cut interest rates drastically after the crisis and then some countries tried to raise them again quite early on. All those countries ended up unwinding those interest rate increases, in general taking interest rates to even lower levels and generally having weaker recoveries thereafter. I am entirely content that what we did was the right thing and that we could not have better outcomes. With higher interest rates, we would have worse outcomes.

- Q19 Charlie Elphicke:** What is your view on quantitative easing? Do you think that it serves its purpose?

Dr Vlieghe: Yes, absolutely. When we reached the effective lower band, we needed another tool, because we thought the economy needed more stimulus and quantitative easing I think was the right tool. We now, looking back, have pretty clear evidence every time we used that it did work as intended. It re-anchors inflation expectations, which are otherwise in danger of falling below target; it boosts asset prices, and through the boost in asset prices, it boosts the economy. We had some doubts whether over time it was becoming less and less effective and therefore we would have to do more and more of it each time. But the experience of us having deployed it again in August 2016 showed that, if anything, it had a slightly bigger effect than we thought. I think it is still a very valid tool when interest rates are constrained.

- Q20 Charlie Elphicke:** Let's just turn to tariffs. You said that you think that



US tariffs probably will not have a material effect on the UK, but you see a large risk if there is a significant broadening in the scope of tariffs across a wider range of goods. What is your sense of where things are likely to be going forward in relation to tariffs or is that how long is a piece of string and you just cannot judge?

Dr Vlieghe: It is a forecast about a set of political negotiations and strategizing, which I do not feel I am well-placed to make that forecast. The quantitative point that I wanted to make is that all the tariffs that have been announced so far, even the ones that have been threatened so far, are not on a scale that you would start revising your macroeconomic forecasts for the UK. That does not mean that it is not a risk, but the risk is that it escalates even further, a wider range of countries, a wider range of goods and that it starts affecting business confidence and financial markets. That is a transmission mechanism through which it can do a lot of damage, but for me, that is a tail risk scenario as opposed to something that I think is the most likely thing to happen this year.

Q21 Stephen Hammond: Good morning, Dr Vlieghe. Thank you for giving evidence this morning. Taking Charlie's two decades, clearly even before 2007 there were some real issues for the UK economy about strength of productivity growth, but since 2007 we have been beset by a particular productivity problem. Would you say that is mainly structural or are there cyclical explanations as well?

Dr Vlieghe: I am not sure it is the right decomposition. It is a fact that it has now gone on so long and we had productivity weakness both when the economy had lots of spare capacity and the unemployment rate was very high. Now the unemployment rate is very low and there is very little slack, we are still having productivity growth. It looks more like a structural thing, but maybe more useful is rather than comparing it to previous recessions is to compare it to previous financial crises that have happened elsewhere. What we always see, even though we do not have a terribly good explanation for why it happens, is that there is always a drop in productivity after a financial crisis, so the fact that that happened in the UK is not so surprising.

What is more surprising is that once we had lost the level, the growth rate after that, we did not expect it to go back to the previous trend, but we were on a weaker trend than before. That has been more surprising. You can decompose it into the fact that we had an unusually weak investment recovery in the UK, even by the standard of other financial crises and we had an unusually strong employment recovery. The good story is that lots of people got jobs; the bad story is that we did not invest very much and those people ended up working with fewer machines or older machines. That is a direct hit on productivity, so what would need to happen in the future for productivity to improve is we need stronger investment growth.

We do have somewhat stronger investment growth in our forecast, which is why we have a slight improvement in productivity growth in our



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forecast, but we have been predicting that improvement for some time now and it has not happened. Clearly I am happy that over 10 years, the most likely thing is not that productivity growth remains as weak as over the past 10 years, but over the next two or three years, the risk is clearly that the improvement has not yet come through.

Q22 Stephen Hammond: In terms of your written evidence to us, where you said that there will be productivity growth forecast of 1%, but your view is it is skewed to the downside, does that answer you have just given us in terms of investment reflect your rationale for that statement? Because you would expect at this stage, this length after the financial crisis, to see a bounce back in productivity growth. You have seen some short-term indications, only quarters, but there is some evidence of productivity growth there stronger than your 1% forecast.

Dr Vlieghe: Yes, although I would not want to over-sell that. We had a couple of quarters where it looked a little better. Mainly it looked a little better because the modest output growth that we had was achieved with very weak hours' growth. Hours are very erratic, and in the first quarter, it already looked like it was weak again. You have to average these things over quite a number of quarters before you can start making a judgment about whether the trend has changed. I am not convinced that it has yet. I think it is too early to call victory based on those few quarters.

Q23 Stephen Hammond: But am I right in that the rationale for your written evidence to us, it is probably skewed to the downside of our 1% forecast, I think is what you said, because you are concerned about weak investment growth and that continuing or is another factor that caused you to make that statement?

Dr Vlieghe: The link is not so direct. After some years of stronger investment growth and therefore a change in the ratio of machines to people, you would expect stronger productivity growth, but it is not so mechanically linked now over the next few quarters or even few years. First of all, I do expect investment growth to be a little better in the next few years than in the last few years, but there is also a big unexplained part of productivity, so the investment story can in any case only explain about half of the shortfall, so there is also some other thing. From a statistical—

Q24 Stephen Hammond: Do you know what that other thing is?

Dr Vlieghe: It is to do with the diffusion of ideas and technology adoption. We know what sort of things drive it, but we are not able to forecast that, "Oh, in the next few years, it is definitely going to be better than in the past few years". What it needs is a continued well-functioning global economy with firms competing with each other globally and technology and ideas being diffused. Those are interesting words, but it does not link directly into a productivity forecast.

Q25 Stephen Hammond: Just in terms of technology, I think I read



somewhere an executive summary of a briefing from a Fed economist last year that was suggesting that the growth in technology is not necessarily leading to a growth in productivity. Did you see that article?

Dr Vlieghe: No, I did not.

- Q26 **Stephen Hammond:** In your other written evidence to us, you used the words “no precise estimates” and “notoriously difficult to forecast” in terms of productivity growth. Can I ask, do you think that has always been so? Has it become more difficult since 2007? You would have also seen evidence given to us recently by the NIESR, Professor Chadha, who suggests that he thinks, for the first time, there has been a mismeasurement on the downside. Can I ask for your views on that?

Dr Vlieghe: It has always been difficult to forecast productivity growth. For monetary policy, for a while it just was not very important because it was not changing very much. Therefore up to the financial crisis, the committee spent relatively less time talking about productivity growth than now, because it was more stable, so you could just rely on it continuing as was. Maybe in a long time people will look back on this and say, “It was very stable at 0.5% so why was it so complicated?” but it was so complicated because we keep thinking that it is going to improve and it is not going to improve. That is what we are struggling with, that it is a change from before. Yes, it was always difficult to forecast.

Sorry, your other question?

- Q27 **Stephen Hammond:** My other question is that there are other economists who, for the first time, are suggesting to—

Dr Vlieghe: The mismeasurement?

Stephen Hammond: Yes, who suggest there is now a mismeasurement, because it has been an explanation for a while. Traditionally, I think when the Chancellor came here two years, he rather dismissed the idea of mismeasurement, but certainly when the NIESR were in front of us, they suggested they do believe there is some mismeasurement, not to a large extent, but some mismeasurement.

Dr Vlieghe: I have also read those research papers for the UK and for other countries as well. My general take on this is that people are finding convincing evidence that there is some mismeasurement, but even if you were to provide some ways of making adjustments to improve the measurements, even if you were to make all those adjustments, the productivity puzzle would not go away. It would be slightly smaller than it is now, but you would revise history to say, “There has now no longer been a weakening in productivity growth”. It is a question of scale. I am sure there is some mismeasurement and I am sure that as technology improves and more people use digital devices and all these things become more difficult to measure, but all the attempts that have been made to scale it do not unwind the productivity puzzle. That is my takeaway for now.



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Chair: Lovely. Dr Vlieghe, thank you very much indeed for your evidence this morning. We will obviously be considering our report shortly. We are going to just pause for a moment while we bring your colleagues in to move on to the next session. We will stop the cameras for a moment, so you can relax and then we will start again.