

Treasury Committee

Oral evidence: Bank of England Inflation Reports, HC 596

Tuesday 22 May 2018

Ordered by the House of Commons to be published on 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 153 - 210

Witnesses

I: Dr Mark Carney, Governor, Bank of England; Sir Dave Ramsden, Deputy Governor, Markets and Banking, Bank of England; Michael Saunders, External Member, Monetary Policy Committee; and Dr Gertjan Vlieghe, External Member, Monetary Policy Committee.

Examination of witnesses

Witnesses: Dr Mark Carney, Sir Dave Ramsden, Michael Saunders and Dr Gertjan Vlieghe.

Q153 **Chair:** Good morning. Thank you all very much for being here to join Dr Vlieghe, who has already gone through not quite an hour of cross-examination, so perhaps the others can answer first when we are asking questions. We are under some time pressure today because of Treasury questions, so I am sure you will be pleased to hear that as well, so I am going to ask answers to be kept fairly short and we will try to direct questions to specific panel members if we can. But that does not mean of course that others should not leap in to answer if there are relevant point.

I wanted to start, Governor, with this issue of forward guidance. One of the questions that we have already touched on this morning was that the MPC minutes from February 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". With the benefit of hindsight, would you accept that that was a rather confusing statement about the future path of monetary policy?

Dr Carney: No. I listened to Dr Vlieghe's testimony earlier. As he said, effectively what that statement said was there were more likely to be three rate increases required over the course of the next few years than two. That is the first point. Second, if the economy evolved broadly in line with the committee's forecast, that would be required. What happened was the economy did not, in the first quarter, evolve broadly in line with our forecast. Inflation came in lower, economic momentum, the number of signs were lower and then ultimately the hard data came in lower as well.

As a committee we stepped back, looked at that data and took our own assessments. Some of us were comfortable with raising interest rates at that May meeting, others of us—myself included—thought it made sense to take a bit of time to see that the momentum in the economy that I expect, that we expect as a committee in our forecast, to re-establish itself before raising interest rates. We give guidance. The guidance is conditional on the economic outlook. If the outlook changes, the actual policy stance will adjust. Of course the policy stance is determined by the sum of the individual decisions.

Q154 **Chair:** Do you think that understanding that the committee has, that obviously if circumstances change, then policy and the response will change, is widely understood by those outside? I am thinking particularly—leaving aside economic commentators and those who study these things in great detail—obviously a lot of businesses, in deciding whether to invest and consumers, whether they decide to take out mortgages and choosing a variable or fixed rate, what duty do you think



the MPC has to help them with understanding the future path?

Dr Carney: That is absolutely the right question. Our guidance is first and foremost to households and businesses across the country, the people we serve. If you look at household expectations in the run-up to the first rate increase in a decade in November, they were correctly anticipating that. If you look at survey evidence of households and businesses over the course of this year, including today—the most recent household survey came out yesterday—more than three-quarters of households expect rate increases over the course of the balance of this year and then to proceed at a very gentle pace relative to history.

We do not have time for it, but if you look on page 5 of the report, which gives a market expectation of that path, roughly three increases over the course of the next three years, and compare that to previous rate increase cycles of the MPC, I think it is something on the order of six increases over 12 months. The general understanding in the country, households and businesses, is it is the former, a gentle path, rates more likely to go up than not, but to go up at a gentle pace. That permits them to arrange their affairs accordingly.

The other thing—and I will stop with this—they expect us to do, and you would expect us to do, is if circumstances change to adjust policy, so we need to be prudent. Our view, my view, is not that circumstances changed in the first quarter. It is more likely to have been temporary and idiosyncratic factors that slowed the economy, but I felt that it was appropriate to wait and get some more data to ensure that that was right, particularly in a circumstance when we are talking about relatively few rate increases over a relatively long period.

Q155 **Chair:** We are going to come on to look at some of those potential factors, but the MPC often indicates that the likely path of interest rates, they base it on the forecast, on market yield curves, and then saying whether that yield curve is too high, too low or just right. Again, do you think that process is understood by households and businesses as opposed to financial markets and journalists?

Dr Carney: I think that is why we give guidance such as "limited and gradual", broad outlooks for the direction of interest rates and the potential quantum of interest rates, because we would not expect households and businesses to check out the OIS curve, the SONIA curves, the movements in LIBOR volatility et cetera. That is not reasonable. We are trying to speak directly to people. I think people have been getting the message. There is ample evidence of that. In terms of market volatility, yes, there will be times when the market is ahead of us in terms of anticipating changes in economic data, when to bring forward potential rate increases, when to push them back, and there are times when we might be a little ahead of the market. We might have a read of the data that is a bit ahead of the market, but to put this all into context, interest rate volatility today in short-term markets is very, very low relative to history and it is very low relative to the degree of economic



uncertainty. There will be times when there is an adjustment as data comes in, but this is not a volatile market.

Q156 **Chair:** If you were watching Dr Vlieghe, I think it is clear we asked him and his response in the questionnaire was that the risks posed by the MPC producing forecasts for bank rate are outweighed by the potential gains for greater clarity and consistency. I wondered where each of you stand on that debate. Perhaps, Sir Dave, we can start with you.

Sir Dave Ramsden: I think it is a good debate to have. We have been talking about it internally on the MPC. Jan has put forward his position and again this morning. Personally, I have to say I am more sceptical. Going back to what the Governor has just said, I think our communication is working well. I think it has been consistently reaching businesses and households, as surveys show. In the latest "Household Finance Index" survey published yesterday, 80% of households expect a rate rise over the next year. Our communication is very much framed in terms of our remit, which is to achieve price stability, and subject to that, to act to support growth in employment. I prefer for our communications to be relative to how we see the economy developing, going back to our remit.

I do think, as I think Jan recognised this morning, there is also a cost, a real risk that I would put more emphasis on than Jan, that things get lost in translation, that forecasts of interest rates are predicted to be and seen as promises. We have seen a bit of that with interpretation of our recent guidance, so that would be my worry if we went down the rate path course.

Michael Saunders: Let me make a couple of points about this. First of all, the monetary policy stance depends not just on the current level of bank rate, but on the expectations of households and businesses for where interest rates will go over the next few years. We have an interest in trying to ensure that those expectations are consistent with the inflation target. The second is there is no way in which we or any central bank can give an accurate unconditional forecast for where interest rates will go over time, because of course the path of interest rates depend on what the economy does and there are always surprises in that.

What you see is different central banks responding to those issues—ie the desire to say something, but an inability to give precision, unconditional precision—in different ways. Some central banks publish forecasts; some central banks give guidance; the Fed do their dot plots. Myself, I think it is very useful to give broad guidance to households and businesses for where interest rates are likely to go over time. I am not a big fan of publishing precise interest rate forecasts quarter by quarter. I think it is an issue really of false precision, that people might interpret a precise two decimal point forecast for where bank rate is going to be in four quarters' time as indicating greater certainty than is possible.



Having said that, I think one area where it might be useful to do more is talk a bit more about where a neutral level of interest rates is. At the moment, I think policy is providing stimulus. If spare capacity gets used up, then it is likely over time that we would want to move to a more neutral rate, I think a neutral rate significantly lower than it used to be. Trying to sort of flesh that out, talk a bit about where a neutral rate might be would be a useful thing.

Q157 Chair: That is very helpful. Governor, I do not know if you wanted to add to that. The other question is if you can see the market have the forecasts wrong, do you think the bank or the MPC should step in to correct market forecasts on the path of interest rates?

Dr Carney: Let me pick up where Mr Saunders just left off, which is around the neutral level of interest rate or so-called r^* , something that went sharply down for secular reasons, reinforced by the crisis, and arguably has been rising over the course of last few years. We have been talking about this as a committee, about, as you would expect, what the level could be or a range of potential levels. I think you can expect that we are doing further work on this and as a committee our intention is to report on that work in the August Inflation Report. That is the first point.

The second point is if you put that together with the other additional information that we are now giving as a committee, we provide our view of the natural rate of unemployment. We are providing our views on productivity as per the discussion previously and the rate of potential growth. Again, to speak to businesses and households, we talk about the speed limit of the economy, the speed limit of the economy around 1.5%, so it has lowered down. You have a pretty full picture of the supply side of the economy, potentially a sense of where we view where policy would be neutral, so you can judge where our policy rate is today relative to how much stimulus it is providing, and then it becomes more of a question of where demand is going to go, where the momentum is in the economy.

If I can bring it back to the current situation, all that information will be out there and the question is: is the economy re-establishing that momentum over the course of the next few months? Then with the guidance on rates certain things logically follow.

In terms of the question on publishing a path, we had rigorous discussion of this as a committee. The consensus of the committee or the majority of the committee was not in favour of publishing a path, but it was the right question to ask. There are arguments for and arguments against. I think the risk of it being interpreted as a promise, as a commitment, is real. There are risks of procrastination once you put a path out there. There is a famous example of central banks adjusting their rate paths at years 2 and 3 and that being the answer to how much stimulus they were taking away or loosening as opposed to taking a decision in the short term. There are risks of precommitment as well. You have a path; you feel more obliged for reasons of credibility to follow it through.



That brings me to your last question, which is around market expectations. We provide guidance and we provide that guidance conditional on the outlook for the economy. We do expect the market to update their expectations accordingly. The market is pretty good at this. Sometimes we get there a little earlier than the market; more often than not they get there before us, which I do not think is a surprise, in terms of their economic outlook.

The last point I would make though is that part of the reason why we have been providing guidance over the course of the last few years is the country has been subject to a series of supply shocks, a large supply shock because of the financial crisis, a large positive supply shock, changes in the labour market, lots more labour supply, a potential future supply shock with Brexit that has changed expectations. In all of those circumstances, providing guidance reduces some of that uncertainty not just for market participants but, very importantly, for households and businesses of what it means for policy.

Chair: That is very helpful.

Q158 **Wes Streeting:** Good morning. Your latest forecast is little changed from the previous one. I just wondered if this is because you attribute the first quarter slowdown entirely to the Beast from the East and, if so, how confident you are about that judgment.

Dr Carney: Not entirely. As we detail in the forecast, our analysis is based on the sectors, the components of demand that were affected, that were particularly slowed. The retail side and the distributed services side are more likely to be affected; construction obviously is more likely to be affected by weather. That is what happened. We use things such as social media data, specifically Google search data, which has pretty good correlations with this historically, and triangulated in on an estimate, I think we say in the report, of 0.1%, but for me around 0.1% to 0.2% of that slowdown from 0.4%, which is what we had forecast prior to the weather changing, to the 0.1% that was reported. We are also conscious that the first quarter of the year there is a historic pattern that that is often the quarter that is most revised over time, so there is some upside there.

All that said, there is a bit of residual softness, arguably, in that first quarter, which is one of the reasons why it makes sense—at least for me it made sense—to wait to see that the momentum is re-established, as I do expect it to be.

Q159 **Wes Streeting:** Can I probe a little bit further on the weather? In your report in box 3 on page 17, you refer to snow as a significant driver. I just wondered how significant you thought that was, not least because you will also have seen the ONS judgment that the effects of snow were “generally small”. I just wanted to explore a bit further the apparent discrepancy between the bank’s assessment of the impact of snow and the ONS’s. Governor, and any of the rest of you, feel free to have a view.



Dr Carney: I have started with it; maybe you want to—

Chair: Dr Vlieghe, you are nodding.

Dr Vlieghe: I think it is useful to explain how we make our assessment of the snow disruption versus how the ONS makes theirs. The ONS includes a question to the firms to say, “Were you affected by snow?” and then the response to that question tells them whether it was large or small. That was the basis of their comment in the release to say there was only a small effect from snow.

We probe the individual components of output, compare it to previous instances when there was snow, which sectors are more likely to be affected than other sectors, and were these indeed the sectors that this time around were also weak, which was a completely different approach. That led us to conclude that there was a more significant effect. It is not that we are contradicting each other. We are using two completely different methodologies for assessing it.

Dr Carney: If I may just supplement very quickly, one of the things on the ONS question was there was very few returns from that question, so very few firms answered the question. Of those who did answer, a lot of them said, “No, we were not affected by the snow”. We used our agency network to obviously go out and ask the same question, and since they go out and visit hundreds and hundreds of businesses across the country, people answer the question when they see it. Not surprisingly, the answer on the retail side, the construction side and distributed services was, “Yes, we were affected by it”. That plus what Dr Vlieghe just said plus the social media data that is referenced in there, again it is a triangulation. It is a judgment. In the fullness of time we will see it.

The one thing I would say, if I may stress, is we do not think much of that lost output is going to be made up. That is one of the reasons why we have a 0.4% forecast for the second quarter.

Sir Dave Ramsden: All I would add to what Dr Vlieghe and the Governor have said is—and this is well-known—in their first estimate of GDP, the ONS has a little over 40% of hard data. Based on surveys, they are having to fill in the gaps and they will have ways of filling in the gaps, including looking at these additional questions that they ask, which is why we try to look across a comprehensive range of data, looking at what the agents are telling us. The ONS is on a modernisation path where it is refining the way that it is producing those early estimates of GDP, but traditionally there is quite a lot of uncertainty, particularly around those first estimates and then particularly when we have bad weather.

Q160 **Wes Streeting:** Your analysis makes common sense as well in terms of the impact on particular sectors, but I want to turn more generally to quite severe turbulence in the retail sector. Mothercare has just announced 800 job losses. We have lost 13,000 retail jobs in the last year; one in 10 town centre shops are now empty. I wonder what the



view of the bank is on what is driving these kinds of job losses. Obviously, inclement weather in the first part of this year will have had some impact this year, but I wonder what your analysis is of whether this reflects a structural decline in the high street, an indication of weakness in consumer spending, impact of technology and automation. What is behind this because it is having quite a disruptive impact, not just on jobs but on communities?

Dr Carney: I think we should start by acknowledging that this country has the most competitive and in many respects the most innovative retail sector in the world. Part of the consequence of that is that consumers are well served, margins in the sector are very tight, and births and deaths of firms, even historic storied names, are frequent. That is the first point of context.

The second point is that this institution, the Bank of England, meets, as you would expect, with retailers up and down the chain, up and down the country. I meet regularly with all the retail chairs and have had a series of discussions particularly around the secular drivers of this phenomenon, which are very much linked to the changing spending habits of British consumers, the steady growth of online, much less footfall and, as a consequence of that, there are a number of retailers who are left with legacy assets and costs that make them uncompetitive and add to difficult trading. Then on top of that, there is more difficult trading conditions. Let's abstract from the first quarter because it is not really a first quarter snow story, but it is more broadly what is happening to household spending with the real income squeeze.

Just to put things in context, we have in our forecast a gradual increase in consumption spending, household spending, in line with the growth in real income. We had expected and we are seeing this pick-up in wages and we expect it to continue at a modest pace going forward and consumption growing in line with that. The pace of consumption growth in our forecast is one-half the rate that consumption was growing prior to the referendum and one-third the rate that consumption was growing prior to the financial crisis. It is just a different order of magnitude and in an environment where you have tight margins, you are getting these broader secular pressures, and you have legacy costs and legacy estates, it is a very difficult environment, even though we expect the economy to grow slightly above its new lower speed limit of 1.5%.

Q161 **Wes Streeting:** Does anyone else on the panel have anything to add to the Governor's remarks on that front?

Sir Dave Ramsden: All I would add is that against that backdrop of already weak consumption growth, since through last year it was half what it was prereferendum, we are obviously very mindful then when we see a range of data as for Q1 that suggests consumption could be even softer. Looking at consumer credit data, for example, it does not have a particularly good predictive relationship with consumption, but these are still indicators that we are very alert to. Again, for me, that was why in



the May decision, while I thought that the weather had been a material factor, I was also wanting to see more evidence of whether consumption is going to be sustained at the 0.2% to 0.3% growth that we saw through last year or whether it is going to fall further and felt that we could wait to see. It is obviously an absolutely key sector for the UK economy and one we scrutinise very closely.

Q162 Wes Streeting: Yes, of course. I was going to ask about consumer credit. There has been a sharp downturn in consumer credit in recent months. I wondered whether you view this as a welcome sign in terms of financial stability or a worrying sign of consumer slowdown. How is the bank judging this?

Sir Dave Ramsden: Since you have asked me, Mr Streeting, I will start. From an FPC perspective, obviously from before I joined the FPC and since, we have been very focused on what was happening in the consumer credit market. We had seen double-digit growth rates. Since then, we have seen some slowing from above 10% to below and there was a very marked slowing in the March data. Then looking at that, that brings you back, if you like. Rather than be a risk factor to financial stability, which was our concern from the FPC perspective, consumer credit is another indicator that we are looking at in the context of the health of the consumer sector.

It may be that there are idiosyncratic factors that are depressing that very weak March reading. I think it was the weakest for many years, but again it shows that we look across the range of real economy data but also credit data to try to build up a complete picture, looking across our different responsibilities, whether for monetary or financial stability.

Dr Carney: Broad brush, consumption out of income growth, not debt-fuelled consumption, so big picture, that is what will drive. The question there, if I can put it this way, the downside risk, is whether UK households decide to make up for the reduction in savings that they have had over the course of the last couple of years as they have had this real income squeeze. Real income squeeze just starting to come to an end, wages growing faster than inflation, we do expect consumption growth to grow in line with that wage growth but it is possible that they will make up for some lost ground.

That is what we are watching very closely, so when we look at consumer credit figures we are looking more for an indication of general consumer behaviour. It is very early days, but looking at the monthly figures across Barclaycard, the monthly Mastercard figures and the Visa figures, they tell a slightly different story, but you do see some element of a pickup again in consumption spending. It is early days and that would be retail and that is only a subset of overall consumption.

Q163 Wes Streeting: Are you worried at all that that real income growth is being outweighed by price increase pressures, meaning the price of fuel at the pump, for example?



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Dr Carney: No, because—well, I should not say no, the point is that the real income growth is adjusted for. It is nominal wage growth, what people see in their pay packet, adjusted for overall consumer prices, so what are they left with in terms of increased spending power? There is some potential of increased imported inflation. There are a couple of things in the short term, and which we flag in the report, that are going to happen. The sugar tax is going to come in and that flows through. There are some utility price increases that are also going to flow through.

As I think we are all aware, the price at the pump has gone up, approaching £1.30. That concentrates the mind of households, but on a broad brush we expect, as we say in the report, that inflation, which has come down to 2.5%, probably tips up a bit in the coming months before resuming a decline. I think that is still broadly right. There is that real income growth we would see, but it is not large and there is this past reduction of savings that has been there, which creates some downside risk.

Lest anyone take too much of a signal from that, there is obviously an upside risk, which is that we have the highest employment in over 40 years. The unemployment rate is 4.2% and real wages are again growing with the most recent regular pay numbers at 3%.

Q164 **Wes Streeting:** I am conscious of time. One final, very brief question from me. The First Minister of Scotland has indicated that she is going to initiate a new round of debate about the prospect for Scottish independence. Ahead of the 2014 referendum, you said a currency union was incompatible. Have you changed your view on that?

Dr Carney: I think my words were a little more carefully drawn than that. There are a number of requirements for an effective currency union and they include an element of fiscal union. I think that is pretty widely accepted. It is clear there are different ways to construct that. It also includes having a form of financial market union, banking union and capital market union, all the components that the European monetary union is still trying to fully construct. I think the best way I can frame it is to quote the president of the ECB, who has said repeatedly that European monetary union is unfinished business because some of the elements are there but not all of the elements are there.

Q165 **Wes Streeting:** Particularly political union, presumably?

Dr Carney: From an economic perspective it is not necessary. The question is from a political perspective if you have the shared economic sovereignty you require a political union, but there are lots of other determinants of whether one has a political union that others can judge.

Q166 **Chair:** Before I bring Charlie in, I wanted to return from the high politics of Scottish independence to the retail sector. I would be interested to know from your conversations with major retailers, but also responses from your agents whether business rates and the level of business rates



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is having—

Dr Carney: The short answer is yes. Yes, it is a real issue.

Chair: That is very interesting.

Dr Carney: It is one of those issues that is guaranteed to come up in every visit to business regional roundtables, yes.

Q167 **Chair:** Is that a conversation that you have had? Do you pass that intelligence on to the Treasury?

Dr Carney: I pass a variety of things on, yes. We pass on our impressions, but obviously we do not lobby on specific issues.

Chair: No, that is for all of us as constituency MPs to do.

Q168 **Charlie Elphicke:** Dr Carney, before I turn to monetary policy, can I ask you to clarify what you were just saying about economic union and political union? Could you explain the point that you were just making a bit further?

Dr Carney: The question was asked whether a currency union requires a political union. My response, what I intended to say was no, from the strict economics it does not. It is for others to judge whether the degree of shared sovereignty, such as some form of fiscal equalisation arrangement, which is highly desirable for an effective currency union, in and of itself has political ramifications. That is an observation that then drifts into politics for others to answer.

A final point: there are lots of examples in this world where economic sovereignty is shared. Global financial regulation is one of many examples; trade agreements is another example. Economic sovereignty is shared and there is not a political union. That is your world. Those are political decisions to be made.

Q169 **Charlie Elphicke:** Mr Saunders, I have been looking at your voting record on the MPC and it seems it could not be said you follow any kind of Bank of England groupthink because in the last year you have been outvoted in the minority, a hawkish minority, no less than five times. Why?

Michael Saunders: In mathematical terms, it is because the others did not all agree.

Chair: Charlie, you are a Whip, you should know that.

Charlie Elphicke: An ability to count is a useful thing in politics.

Michael Saunders: Maybe I should explain as to why my view was different at the last meeting. I broadly share the Inflation Report narrative that the economy currently has a limited amount of spare capacity and over the forecast period will probably move into excess demand. If that is how things develop—if, conditional—then interest rates probably will rise over time.



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I differed from the majority in two areas. First, I put more weight on the view that the weakness in Q1 GDP reported by the ONS is either erratic as a side effect of the weather or possibly may be revised away, as the Governor mentioned. Weakness in Q1 has often been revised away subsequently. I suspect that the jobless rate will fall a little further than our base case over time. Surveys suggest that firms' hiring intentions remain pretty buoyant, a little bit above average, consistent with job growth of probably more than 1% year to year. Workforce growth is running at 0.8% year to year. It is unlikely to accelerate and I suspect the jobless rate will fall a bit further, reinforcing upward pressure on the growth of pay and labour costs. I favoured a slightly earlier tightening path than was priced into markets and I voted accordingly.

Q170 Charlie Elphicke: So that I understand, is your concern that you think there is a risk that the inflationary pressures in the economy are understated because the labour market is tighter than is being accounted for, which seemed to be the base case of your argument in the University of Strathclyde speech just over a month ago?

Michael Saunders: I want to stress I do not think the labour market is currently tighter than we expect. I suspect that going forward the labour market will tighten further with the jobless rate continuing to fall, but I stress I do not think that the labour market has yet overheated. We are probably close to an equilibrium level of unemployment. Pay growth seems to be picking up. You can see that reflected also in the growth of unit wage costs and unit labour costs, and I suspect from here the labour market will continue to tighten.

Q171 Charlie Elphicke: To understand this properly, your prime concern is you think the inflationary pressures in the economy are stronger or greater than the consensus?

Michael Saunders: Will turn out to be stronger, yes, if—as I expect—the labour market tightens further, yes.

Q172 Charlie Elphicke: You want to get in ahead of time, as it were, or in advance?

Michael Saunders: I would not regard it as getting ahead, I would regard it as just trying to vote in accordance with what the outlook is. In general, there is a cost to waiting too long, which is that interest rates might have to rise a little faster than otherwise, but I am not trying to get ahead of the curve, as it were.

Q173 Charlie Elphicke: Other than inflationary pressures that may result from a labour market in future, are there any other inflationary pressures that concern you?

Michael Saunders: In the near term, you have some upward pressure on inflation, which will limit the extent to which inflation falls, from the rise in energy costs. More broadly, the inflationary effects from the drop in the pound that was triggered by the Brexit vote are starting to fade.



The peak effect from currency swings to CPI inflation is usually about 18 months. It takes about four years in total for the effects to wash through, but the peak effect is after about 18 months. That has been a major factor pushing inflation up over the last year. That is starting to fade. As that fades, unless energy does something strange we will probably see CPI inflation fall over the course of this year, not necessarily in every month.

Q174 Charlie Elphicke: The Inflation Report notes that the impact of the depreciation of sterling is now expected to have a smaller impact on import price inflation than previously thought. Why is that?

Michael Saunders: Interesting question. What we see in the data is that typically over a long period of time import prices move about 60% of the swing in the exchange rate, both on the way up and the way down. That is what we have built into our forecast. What we have seen since the Brexit vote and the depreciation of sterling from that is that import prices have risen only about 50% of the depreciation, so a little bit less than we would normally expect. It is not quite clear as to why that is. It may be that if you go back to the period when the pound was quite strong, back in 2013 and 2014, import prices in that period fell less than you would have expected given the appreciation of sterling.

There may have been some widening on margins into the UK and that may have unwound in sterling's depreciation or it may be that there is a bit more import price pressure to come. The view we have taken over the last year was that there would be some import price catch-up. Having not seen that, you see there is a slight shift in our forecast to assume that that import price catch-up probably will not come through. That has a marginal downward effect on the inflation forecast going forward.

Q175 Charlie Elphicke: Looking at your public statements, my impression—correct me if I am wrong—is that while many of your colleagues and many in Treasury are deeply concerned about the impact of Brexit you seem a little more sanguine. Is that fair? What is your analysis on the Brexit impact and the risks of that?

Michael Saunders: The work by the IMF and the OECD, bodies based outside the UK, highly reputable, suggests that Brexit will probably have a modest adverse effect on the UK economy over the long run. I stress “modest”, “long run” and “probably” because we do not yet know the full terms of it. I broadly share that, and I think you have to separate those long-run effects from the question of the short run. The economy did not weaken as much as the bank's forecast in the middle of 2016 expected in the very short term, but it is clear, or at least I think it likely, that that long-run narrative is probably still intact. Obviously, that is something that we will learn more about over time.

Q176 Charlie Elphicke: Dr Carney, what is your analysis on these matters?

Dr Carney: I have not released a long-run analysis on these matters so I will probably keep that to myself. I think we should take a step back



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though on the short run. The relevant starting point is our forecast in May of 2016, so the forecast on the eve of the referendum, which was predicated on a vote to remain because we always use the status quo when we do a forecast and was predicated on relatively weak European and global economies.

If you look at where the economy is today relative to that forecast, it is more than 1% below where it was, despite very large stimulus provided by the Bank of England, a fiscal easing by the Government and global and European economies that are much, much stronger than they were previously. If you adjust for those factors, and one should not be too precise about it, the economy is about 1.5%, 1.75%, up to potentially 2% lower than it would have been, than one would have expected. That is a reasonable difference. If you map it into household incomes, which is also something we forecast, real household incomes are about £900 per household lower than we forecast in May of 2016, which is a lot of money.

The question is why and what drove that difference. Some of it, and we cannot be absolute about it, is arguably ascribed to Brexit. One of the things we have seen, for example, is that investment spending has been quite weak given all the positives for investment spending: clean balance sheets, healthy financial conditions, robust global economy. We put some analysis around it based on surveys of up to 4,000 firms across the country; 3 or 4 percentage points lower last year than one would have expected. We do not think that effect is getting worse. We do not think it is intensifying. We now think that it has reached a level and will start to move up, and that is key to our forecast.

The behaviour of households is influenced heavily by where their real incomes have gone, and one of the biggest drivers of that has been the referendum-induced fall in the exchange rate and the inflation that has come through, what you just started with. There are Brexit effects that come through. There is also an overall, though, productivity effect—and I know Mr Hammond was raising these issues earlier—a continuation of this very poor productivity performance, some of which is obviously linked to lower investment but there are lots of other explanations. We can give you a long list of those explanations, but not with great precision and high confidence of which ones are actually driving it.

My point is that in the short term, over the course of the last year and a half, there has been an impact relative to what we would have expected even with some pretty good tailwinds at the back of this economy.

Q177 Charlie Elphicke: Would you accept that with interest rates having been as low as they have been for as long as they have been there is no incentive, particularly in the UK economy, for capital to be allocated to best effect?

Dr Carney: No, I would not accept that. I think you do see evidence, and again I think this was part of the previous exchange and I am happy to



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share it with the Committee. We have looked at this question of so-called zombie firms, firms that are not covering their interest with their earnings before tax or their EBIT. That has steadily gone down over the course of the last five years.

There are lots of good things going on in this economy; let's start with the labour market. One of the other things is that the business market is turning over. Firms that should be going out of business are going out of business. They have my sympathy in cases and certainly their employees do, but it is part of the natural process. New firms are being formed. What we are getting less of is investment, but again let's put this in context—and I will finish here—which is that it is understandable why businesses are holding back. There are some big, big decisions that are about to be made.

Why wouldn't they wait a little while longer until the path is clearer? We do not have a sharp increase in investment in our forecast over the course of the next three years. You could build a case to have risks on the upside, and I could build a case to say that with clarity that ultimately comes, big long-term decisions that are taken about the relationships with Europe, businesses will then use those clean balance sheets, access financing and start to put capital to work and we would see a sharp pick-up in business investment.

Q178 **Charlie Elphicke:** Finally, will you write to the Committee with your analysis on why it is that low interest rates do not have a zombifying effect so that we can understand your full analysis of this particular issue?

Dr Carney: Happily, but we will start with the fact that there isn't an issue and then we will move from there, yes.

Chair: Thank you. We will look forward to that.

Q179 **Mr Clarke:** Dr Carney, I will turn to quantitative easing and the impact that that has had over the course of the policy since 2008. Obviously since the last Inflation Report the bank has published its own analysis of the impact between 2008 and 2014 in terms of inequality. That analysis found that the impact overall had only been very modest on the basis that households had a similar impact in proportionate terms, but isn't that a bit of a copout, given that we know that in absolute terms the top decile gained £350,000 a household and that compares to the lowest decile gaining £3,000?

Dr Carney: Thank you for the question and thank you for taking the time to review the analysis, which is the latest in a series of analyses that the bank has done on this issue. I should state at the outset to be absolutely clear the distributional consequences of our policy are not part of our remit, but we do look into it and obviously it is for others to consider those and, if appropriate, take steps to offset those.



The second thing, as you referenced at the start of your comments, is that, broad brush, income and wealth distribution has not worsened over the course of that period. Then before I turn to the specifics, another top point to recognise in terms of our contribution to these issues first and foremost is inflation at target, because inflation hurts the poor the most, and people in work, many people in work first, and our analysis also contained in that is that the economy is about 8% higher than it otherwise would have been, 2 million more people in work, inflation at target. These are the big contributions the Bank has made.

Q180 **Mr Clarke:** Absolutely. I am looking at the side effects, if you like.

Dr Carney: To get into the specifics though, in an environment where all groups are measured by decile—and as you have seen it is cut and diced in various ways—so you split the population into tenths, all of them have improved on both income and wealth over that period. Then when you take a proportionate increase into actual pound values, you come up to the reality that there is unequal distribution of wealth and income in the country and that a 10% increase in the wealth of somebody in the lowest decile, the poorest in the country, is a lot less by definition in pound terms than it is for those in the top decile. That is a product, as I say, of inequality. Inequality in this country, as I think you know and would have seen in the report, went up quite sharply in the 1980s, into the mid-1990s, and it has more or less levelled off since then.

Q181 **Mr Clarke:** Looking at this, isn't there a distinction to be drawn between consumer price inflation, which was the objective of QE to make sure that the prices held up, and asset price inflation? Given that the benefits of QE have disproportionately accrued to the wealthiest in society who have the greater ability/propensity to save, hasn't that fuelled asset price inflation, whereas what we are looking to try to achieve is consumer price inflation? Isn't that the fundamental public policy failure here?

Dr Carney: First, there is not a public policy failure here. The objective of the Bank, the remit given to us by Parliament—you can change the statute if you want to swing it over to asset prices; I would not recommend it personally—is low, stable, predictable consumer price inflation and, very importantly in a situation such as following the financial crisis, to avoid unnecessary volatility in output and employment, which means subject to the first, keep as many people in work and the economy growing and as close to capacity as possible, which is what we have done.

In terms of the proportionate impact of these policies, in proportional terms it has made the biggest difference to those the least well-off starting with staying in work. Secondly, those who are heavily indebted have benefited more from lower Bank Rate than those who have savings. That causes intergenerational issues, which are detailed in the report and recognised in the report. The policy has worked for its objective. We have gone into quite a bit of detail in terms of the distributional issues, which are not our direct responsibilities.



From a monetary policy perspective, we care about them because different cohorts of people, different levels of indebtedness, different levels of wealth behave differently. We need to know what proportion of the economy is heavily indebted so when we raise interest rates how much that will squeeze on them because the marginal propensity to consume is much higher for those people than it is for those who will benefit from an additional interest income, for example, on their savings accounts. We need to know these distributional effects for those reasons but, of course, it is in the public interest that we do this analysis and provide it.

Michael Saunders: I thought that a really fundamental point of that paper was that when you consider the distributional effects of the monetary policy over the last few years, you should not just think in terms of low interest rates punishing savers and rewarding borrowers or asset price inflation only benefiting those who have assets. The monetary policy actions during that time helped to support growth, jobs and incomes, and the benefit from that came through widely to pretty much all parts of society. I think that is a very important point.

Q182 **Mr Clarke:** Absolutely. It is just about understanding the impact in the round that this has. Would you accept that it has artificially made the rich richer while achieving desirable goals as well?

Michael Saunders: I think that it has helped the economy to recover from a recession that could have developed into a slump, with the job losses and high unemployment that would have accompanied that.

Dr Carney: If I may, Michael, one of the issues is you have the term "artificial" inserted in there, and it goes back to something we were talking about 45 minutes or so ago on the equilibrium rate of interest, which is that one of the things that has happened over the course in our judgment, and I think it is borne out by events, for reasons of global flows of investment and savings, for big secular developments in demographics here and abroad, increased inequality globally, not in the UK, but increased inequality globally, other factors, has been to push down this equilibrium rate of interest.

On top of that came a series of major cyclical forces; think fiscal consolidation, think broken financial sector, other things that further pushed it down, so the equilibrium rate of interest goes down. That is a combination of real and nominal developments, but at its core real developments to push down equilibrium rates of interest. As the discount factor goes down, the value of a series of other assets goes up, everything else equal. Those who own the assets have the benefit of that. The wealthy own the assets by and large and that is what has happened.

The second point, which is relevant but unrelated, is that again if we look at where asset prices have gone in the country on a real basis, house prices in the UK are still not yet back at their 2007 level in real terms.



They are about 15% above in nominal terms but they are still not back on a real basis.

Q183 Mr Clarke: In terms of house prices, with my politician's hat on, I think one of the great reasons the Conservative Party fared quite badly in last year's general election was this issue about Generation Rent. I do have a concern that QE has, if you like, solidified some of the obstacles to young people ever being able to own their own home because asset prices in Britain are disproportionately linked obviously to house prices. Sir Dave, obviously the analysis confirms that when you include future housing costs, the youngest households are net losers from QE. What would you say to them about what the impact has been on their lives and how that impact can perhaps be unwound in years to come?

Sir Dave Ramsden: These are all really important questions for the economy and for society, but we have to locate them in what the Bank of England is responsible for and what it is not. Going back to the analysis I used to do in my previous job at the Treasury, we know that the UK is unique in having had sustained increases in real house prices over multiple decades. We know that that ultimately flows from supply side constraints. That is the structure of the economy that then monetary policy—and it is not just QE. QE is one part of our monetary policy toolkit but, as the Governor was just saying, we are in a world with very low equilibrium interest rates. We have therefore also been in a position where the nominal bank rate has stayed very low, which has also contributed to the economy. Where we are now, real house prices are still below where they were pre-crisis by about 7% or 8%.

Turning to your point about where the analysis in the distributional paper has been extended, they have tried to look at what the future housing costs are for that younger generation and they admit they have made some very strong assumptions. They assume that real house prices will stay where they are now, whereas normally you would expect over time, as the impact of the monetary policy position at the moment wanes, they would come back down. Also they assume that there are no intergenerational transfers. However, again, as part of what we are trying to do by informing the distributional debate, the staff producing the paper thought it relevant to include this anticipation of future costs that does impact on the younger generation.

I would come back to where I started, which is saying that issues of housing affordability, getting into the housing market or getting on to the housing ladder for younger generations, are ultimately issues for Government—land use, the tax system towards housing and so on—and not issues for the Bank of England's remit.

Q184 Mr Clarke: It is helpful to understand that distinction. Dr Vlieghe, I can see you want to come in. I will just link to my final question—this goes to you as well, if I may—which is that you mentioned in your earlier evidence to us this morning about your reappointment that you thought the 2016 round of QE had had a greater impact perhaps than some of the



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earlier ones. Will the Bank be publishing separate analysis on that? Obviously that is outwith the timeframe of this current piece of analysis.

Dr Vlieghe: I will come to that in a moment. I just want to make a point about your earlier statement that measuring the gains in asset prices in relative terms rather than in pounds is a copout. I strongly feel that it is not. I will give you a very simple example. Suppose that I have 100 of some asset and you have 200. There is some inequality. You have twice what I have. Now suppose nothing interesting happens to the economy other than that all asset prices grow at the rate of GDP growth, which is the normal state of affairs. Some decades later, everything has doubled. I have 200. You have 400. I have gained 100 and you have gained 200 but the inequality is exactly the same. The rich have not become richer. The poor have not fallen behind.

Measuring it in relative terms is exactly the right thing to do, otherwise you come to these very counterintuitive conclusions that inflation benefits the rich or something like that. The only way to measure it is in relative terms. You can make it sound spectacular by looking at the pounds billion number, but it is not a solid way of analysing inequality. I just wanted to emphasise that.

Q185 **Mr Clarke:** I think it is hard for someone who has watched house prices move further out of their reach in practical terms to observe it in that way.

Dr Vlieghe: I am not denying that fact. What I would highlight there is what Dave said, which is that all of those developments predated QE. Think about it this way. Lots of countries have had QE. Lots of countries have had near-zero interest rates for almost a decade. The UK is the one where housing affordability is extremely stretched. If it was primarily down to QE you would have seen that exact same phenomenon in all the countries that had done QE and that is not at all what you see. You see wildly different performance in house prices across those countries, which goes exactly back to Dave's point that the long run developments are about supply. It is not about QE. These are things that long predated QE.

Q186 **Mr Clarke:** Will you be publishing analysis of the 2016 round of QE in due course, do you think?

Dr Vlieghe: We have talked about this quite a bit already in previous reports.

Dr Carney: We are talking about different points. As Dr Vlieghe was just saying, in terms of the monetary impact and the flow-through, yes, we have published that. We can draw your attention to it and provide more detail.

This paper, as a working paper, is an initiative of the staff. It complements other things we need to do to conduct monetary policy. It provides more information. I appreciate your focus on it. It is a good piece of work by some of our top economists. I would anticipate that in



the fullness of time they would refresh the analysis, but it is not a regular part of our work. This gives you a lot of ammunition, if you will, for the story and what is going on in the economy and helps prompt discussions such as we just had. We will continue to look at the distribution of debt, distribution of income and distribution of wealth, what it does to the transmission mechanism of our policy and how it will affect the underlying economy so that we can do our job.

Q187 Alison McGovern: Very quickly, Mr Saunders, on the point that you were making there, "What if we had not done this?" and that you cannot look at the benefits purely in terms of the flow-through of QE to the different groups in society, do you think we have the tools of analysis available to present information about the other side of it or what the costs could have been?

Michael Saunders: This paper does that. It takes a simulation of how the economy might have evolved in the last few years had monetary policy not been loosened as much. GDP would be weaker, unemployment would have been significantly higher and pretty much all parts of society would have been worse off, significantly so.

Q188 Alison McGovern: Do you think it is possible to quantify that?

Michael Saunders: Yes, in broad-brush terms, accepting the uncertainties of all of these kinds of models. The likelihood that the economy would have been weaker, unemployment higher and incomes lower is pretty high.

Q189 Rushanara Ali: Good morning. The bank's decision maker panel survey recorded a small reduction in uncertainty over Brexit among business leaders in the last six months. With the transition agreement reached in March, does uncertainty remain high or will there be an improvement?

Dr Carney: If I may begin on that, that is right. We have seen a small reduction, as you would hope. We have an agreement that still has to be ratified obviously, but it is an agreement between 28 heads of Government and it is in the interests of both sides for that to be followed through.

There is very limited early information. We see a bit in the Deloitte CFO survey in terms of Brexit uncertainty versus the overall effect of the relatively weak state of demand at the moment, as well as in the decision maker panel results that we watch closely and supplement with direct conversations. Thus far it does not look like it is having an impact, but it is very early days. I would go back to the earlier exchange, which is that obviously the progress on the end state, the final agreement that we would all anticipate over the course of the year, will be decisive in this regard, I would expect.

Q190 Rushanara Ali: Great. Did anyone else want to add anything to this question?



Sir Dave Ramsden: The only thing I would add—obviously we would hope that the agreement would give some upside on investment and our investment forecasts—is another source of evidence we have had recently, the Bank Agents’ survey of exporters, and that was a bit more mixed than the Deloitte survey. It is different timing in terms of a different frequency, but it did come out since the transition agreement and that suggested that some Brexit-related factors were moving up the league table of concerns among exporters. It is not an unambiguous picture yet, but if we get more certainty through this year then we would hope to see some improvement in the outlook for business investment.

Q191 **Chair:** Is that survey public?

Sir Dave Ramsden: Yes. It was published alongside last week’s regular Agents’ report.

Chair: Thank you.

Q192 **Rushanara Ali:** Just linked to this point, business leaders attached a 40% chance to a disorderly exit from the EU according to this survey. Presumably the need for a smooth Brexit is critical and could have a major effect on investment. Could you say more about what this looks like in the event of a disorderly Brexit, as the 40% think, and a smooth Brexit, and what that would entail?

Dr Carney: The first thing is to bring it back to the Committee’s forecast, which does assume a smooth transition to an average of potential outcomes. That has been our conditioning assumption since the referendum and it is a conditioning assumption that, by and large, broadly reflects the expectations of businesses and households. I think there was an exchange earlier about the importance of those expectations. That is what drives the decision to spend or to invest. Even with the decision makers panel information and the conversations we have, in general businesses are behaving as if there will be a smooth transition but they are less certain about where that outcome will be and so they have been holding back, as we discussed earlier.

On the second point, what it could look like, if I can switch for a moment to the Financial Policy Committee role on that—this is an area where there is co-ordination in terms of information sharing, very importantly for the MPC—the Financial Policy Committee is thinking actively and analysing what could go wrong if there is a cliff-edge Brexit, if this is not a smooth process, and what the issues are that need to be addressed in order to minimise the impact, through the financial system, on the real economy. First and foremost was to make sure the banks have enough capital liquidity. We did that in the last stress test. We have extensively reported on that. We are very confident in that position, just to be absolutely clear.

Secondly, there are a host of issues, a lot of them in the derivative markets. There are 10 million insurance policies in this country that would not be serviced. As I say, there is more than 25 trillion of



derivatives that would have issues with continuing to be serviced and function. There are a range of issues with data and so on. We have published those issues. We publish every quarter as the FPC a checklist that is helpfully linked in green, amber and red—both for the UK and the EU because there are cross-border issues—that shows what is being done and what needs to be done to address them.

The third point is that we are working with the Government where the UK Government can help find the solution. There is close and effective co-operation there, I would say. The Government have already announced some things that will be helpful in that regard.

The last point—and this has been announced—is that a working group has been formed between the ECB and the Bank of England, which I co-chair it with President Draghi, to manage risks around the exit date. There is cross-border co-operation as well.

Q193 Rushanara Ali: Just to remind us all, what is your definition of a “smooth Brexit”?

Dr Carney: If I start with the financial sector, a financial sector that continues to meet the demand for credit. For businesses, that the new trading relationships or arrangements are seamlessly implemented so that we move from our membership of the European Union and of the single market to whatever those new trading relationships are. That last point would generally require a period of transition, as has been acknowledged with the withdrawal agreement or the implementation agreement, I should say, not least because businesses will need to adjust their supply chains to varying degrees depending on the final agreement. Also they will potentially need to make adjustments to key personnel.

We at the Bank are focusing on a series of issues in the financial sector with a particular focus on what could go wrong if there is a sharp Brexit and what we can do today to minimise the disruption that would come from that. If the implementation agreement does not come to pass for whatever reason there would potentially be considerable real economy adjustment.

Q194 Rushanara Ali: There has been lots of debate about the transition period lately and whether it should be longer. What is your view on that? Is the current length of time long enough?

Dr Carney: I have watched the debate with interest.

Rushanara Ali: The current timeframe is adequate, in your view?

Dr Carney: It is what has been agreed by the leaders of 28 nations. In terms of the financial sector, we, the FCA and the European authorities are actively engaged with the relevant parties to transition and to minimise these cliff-edge risks. Exactly what we are transitioning to, to us as well as everybody else in the economy, is not yet clear because the end state has not been there. We will look to use all the time.



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Q195 **Rushanara Ali:** That is taking quite a long time. I know there has been a lot of will on the UK central bank and regulators' side to get on with planning as much as possible given the end state is not known, but it is taking quite a long time. The ECB only agreed to that or were only given permission to enter into that agreement fairly recently, were they not?

Dr Carney: We are pleased to have the working group set up. It is important and we have shared interests in managing these issues. They have all the right people working on them.

Q196 **Chair:** Governor, you would not have an objection to the time period being extended, would you?

Dr Carney: I think some would have an objection to me answering that question.

Chair: That is another intelligence that gets passed to the Treasury not via this Committee.

Q197 **Rushanara Ali:** Just two very brief final questions. Last year in the Committee meeting here you said that economic uncertainty caused by the Brexit vote will knock 5% off UK wage growth by the end of the year, and also in January at the Davos conference you said that the Brexit vote is costing Britain's economy around £10 billion a year. Have these figures changed in the light of the transition agreement and developments since those statements or do you stand by them?

Dr Carney: No, I stand by them. We are at 4% and counting. I gave the figures earlier and that is a figure that is just relative to what we forecast in May 2016. It is not adjusting up as one might expect, given how strong the global economy is and where this economy might have been. We are managing through the situation. We are going to set monetary policy to get the economy to full capacity, bring inflation to target and provide the supports needed. We are working actively on things we can do with the Government, with the ECB and the European authorities to prepare for any adverse situation so that people can have the confidence to save, hire, spend and invest.

Q198 **Rushanara Ali:** I just have one final question because other witnesses have not had a chance to answer. Earlier on, Governor, you mentioned the fact that household income was around £900 a year less than might have been the case in the pre-Brexit scenario. Given all this analysis that is being done and managing risks, have you been looking at what the likely scenario is on household income going forward in the event of a disorderly Brexit versus some of the other scenarios? Who would like to come in on this point?

Sir Dave Ramsden: There is a distinction between that and what has happened to date, which is what your earlier exchanges with the Governor were on. Relative to the May 2016 Inflation Report we have forecast up to 2018 Q1 we have had weaker nominal wages and higher prices, which gives you a hit to real household incomes that translates into these figures of £900 or so, up to £1,000 on real wages. That is to



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now. When you link it to average earnings in the economy of about £23,000 a year, that is how you get that calculation.

Looking ahead—again, as the Governor was emphasising—from an MPC perspective we assume an average of end states and a smooth transition to those. That is what our forecast is predicated on. That is what drives our real income forecast for households, our wages forecasts and our inflation forecasts. From an MPC perspective we are not looking at scenarios. From an FPC perspective, as the Governor made clear, we are confident that the financial sector can deal with the shock of a difficult Brexit. We have modelled that and that was a key part of how we analysed the financial stability risks around a transition that was not smooth.

Dr Carney: May I?

Rushanara Ali: Yes, please.

Dr Carney: Since you quoted me I will just caveat that last bit. The banks have the capital liquidity to continue lending. There are specific issues that we have detailed, as the FPC publicly released, and we have a checklist and we are working on them. Those need to be addressed, for the avoidance of doubt.

Chair: I am sure people will be rushing to look at the warnings, the red, amber and green.

Q199 **Charlie Elphicke:** Doctor, just following up on my colleague Rushanara Ali's question, you were saying that Brexit has had a reduction in trend growth for the economy, yet last year you gave a speech saying we were taking a step back to jump forward. How do you see the prospects of jumping forward?

Dr Carney: That is the issue. As I would interpret it, that is the core economic thesis. There are other issues with Brexit, broader issues of sovereignty and others with which you are well familiar, but in terms of the economic point there will be some adjustment to the trading relationship with Europe—it remains to be seen to what degree—in order to have the flexibility to have deeper economic relations with others in the fullness of time, which is well beyond the horizon both of the MPC, which only goes out three years, and even of the FPC, which has a longer financial horizon. That will determine the effectiveness of the strategy. I absolutely recognise that.

I would stress as well, as I think I have pointed out a few times, that as there is clarity in terms of the end state, whatever end state that is, there is a strong sense among businesses up and down the country that they will adjust. These are highly innovative, entrepreneurial businesses that are looking to get on with it.

Q200 **John Mann:** Governor, on 6 July you are visiting the people of Bassetlaw, who are extremely excited. What are you intending doing on 6



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July 2019?

Dr Carney: I do not know. If you invite me to Bassetlaw, I will come to Bassetlaw.

Q201 **John Mann:** Would that be in your capacity as Governor of the Bank of England?

Dr Carney: It would be in my capacity as a citizen.

Q202 **John Mann:** You are still leaving in June next year?

Dr Carney: I thank you for your interest. Yes.

Q203 **John Mann:** Entering your last year as Governor, do you see any particular problems—considering there appears politically to be big Brexit decisions in October, November or possibly March, as we keep reading—in the Chancellor and Government having the time to think through your replacement?

Dr Carney: I should not really speak for them, but not at all. The Chancellor and the Government are able to multi-task. They multi-task every day. It is an important decision but one they can take. As you may recall, I extended the time I was going to serve for a year in order to see through what could potentially be the most difficult part of the Brexit process because of some of the issues that we were just discussing.

Q204 **John Mann:** Come October, *The Sunday Times* says there is going to be an election. There could be, by November, a new mandate for the MPC incorporating unemployment and perhaps some other things.

Chair: We are now entering the realms of speculation if we are basing policy on *The Sunday Times*. Do carry on, John.

John Mann: I am just intrigued to know how well-prepared the MPC is for a potential change in its remit at precisely the time when we will be voting how to leave the European Union and the process of that.

Dr Carney: The first point is that, quite rightly, the remit of the MPC is given by Parliament. You are well familiar with the statute and the process of the annual remit letter from the Chancellor, whoever he or she may be. It is our job to faithfully implement that remit.

I would make two points, if I may. One is that in 2013 there was an adjustment. It was the last major adjustment to the remit, which drew attention to how we manage policy under exceptional circumstances. There are two examples of exceptional circumstances. The first is a situation that was discussed briefly earlier, the potential role of monetary policy when there are issues of financial stability. When would we potentially—to use the vernacular—lean into the wind or keep interest rates higher in order to reduce financial stability risk and perhaps undershoot inflation for longer or take longer to get back? That is the big place where policy co-ordination takes place with the FPC. It is an independent decision of the MPC informed by what the FPC is doing.



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The second circumstance is the one we have been in since the referendum up until now, which was managing this trade-off between having a lot of spare capacity with inflation over target. What the MPC has been signalling is that that trade-off has been “diminishing”, it has been going away, as we have moved towards full employment and eliminating spare capacity. We are now in a conventional policy environment and bringing inflation back to target at a “conventional” horizon. Think around two years. That affects the stance of policy. To translate, it makes it more likely to tighten policy.

One last point, if I may, which is that I said in my appointment hearing to this Committee in February 2013 that it is, in my opinion then and still now, a good idea periodically, let us say every five years, every eight years or something like that—not necessarily with the electoral cycle, but it is up to Parliament to decide—to review the remit, make sure it is still fit for purpose and make sure there is a common understanding of what it means and how it is implemented. It is a framework that is used in Canada to great effect. They have reviewed it multiple times and they have not substantially changed it over the years because it is still the best. I would underscore that I would endorse the remit as it is currently constructed.

To part of your question, “Will the MPC implement a new remit?” whatever remit Parliament gives the MPC will implement. Are we well-versed in different variants of price stability mandates, dual remits and those issues? Yes, we are. We would offer those opinions if they were desired.

Q205 John Mann: I am not putting a bet on an election in October, but you reached where I anticipated you might. That would suggest that, should you change your mind, stay for another term or stay for the rest of whatever transition there is, I would be quite relaxed and I am sure there would be plenty of others who would be quite relaxed.

Please do not take any implication from my next question that I am suggesting it is a good thing that you are leaving, but as you have said you are and there is no election, that would be a good time, would it not, for this Committee to be considering what the mandate is? It would be more logical in advance of a new Governor than after a new Governor, it would seem to me.

Dr Carney: Can I stand by my previous answer that it would be logical and desirable to periodically review the remit? My personal view is that this remit is absolutely fit for purpose. It has been demonstrated under maybe not extreme circumstances, but the quite remarkable circumstances that have transpired over the course of the last several years.

Q206 John Mann: In terms of the five years that you have had, what impact has Simon Cowell had on monetary policy?

Q207 Chair: Is that a question for Sir Dave?



Dr Carney: I was hoping it was not.

Q208 **John Mann:** The reason for asking the question is, if I was to make an economic observation, that Simon Cowell has managed to affect the Saturday night economy in a very significant way in terms of how people behave. Huge numbers of the population who were previously going out and spending money, getting taxis, going to pubs, clubs and restaurants, are staying in. They are buying different products. It is a big behavioural change. It does have an economic impact. It could be a big one. How strong is the MPC in looking at the impact of behavioural economics, not just what people are doing but in their expectations? You could argue that people spending far less staying in regard it as an equally high-quality life to spending lots of money going out, but the impact on the economy is rather different. How good are you at the Bank of England and the people you take advice from in terms of considering behavioural economics and has that improved in your term in office?

Dr Carney: Let me start at the end. Yes, I think it has improved. It has improved not necessarily because of my term in office, but because of the nature of the institution. It has not been a top-down edict that we shall improve our understanding of behavioural economics but we have deepened our understanding of it in multiple ways. Let me give a couple of quick ones.

One is around our own unconscious biases, the way we make decisions and the organisation of the Bank of England as a whole, the value of not just diversity, which is incredibly important—gender diversity, different socioeconomic backgrounds, different universities, all of that together—but how we bring those people together and make decisions. The changes we are making to the decision-making process are heavily influenced by behavioural economics to get different points of view, challenges and better decision-making out of it. On the behavioural side, the heuristics people use informing expectations about inflation and about Brexit are also a suite of things that we have looked at.

In terms of the economic consequences of Simon Cowell, it sounds like a research project because of course the question is: to what extent is that displacement spending within the week or within the month as opposed to a fundamental change in consumption? I am sorry, I should finish more quickly. There is a bigger discussion around the so-called consumer surplus that is captured through all our use of social media, smartphones and other things for which we are exchanging data in a largely if not totally non-priced way, and how that is measured.

Q209 **John Mann:** I am hoping in your last year we will hear more about it. It is a critical issue.

Let me ask a final question on another critical issue. One of the big economic changes—you have spoken in the past as Governor quite a bit on this, though I do not think your colleagues have and perhaps they might like to as well over the next year—is green economics, let us call it.



What I have noted is that in those five years the UK has shifted in terms of wind power to being by far the global player. I think a third of offshore wind energy in the world is not just British but English, in fact.

Dr Carney: A lot of the expertise is in the north-east.

Q210 **John Mann:** We have a hugely reduced reliance on imported coal compared to when you came in, which obviously has significant positive impacts economically. In terms of the economic arguments for sustainable domestically produced energy, should we not be seeing more from the bank in the near future? In terms of Parliament, Government and decisions we have made, this has tailed off quite a bit. The time lag from it tailing off will be over the next five years. There are not the incentives there that there were. There is not the drive there. That is my impression, anyway. There does seem to be a slowing down in terms of that shift. Should we not be giving the economic arguments on this even more attention? You were the first that I could see to raise that. Should not you and others, your colleagues, be doing a lot more in the very near future to inform public debate on the economic case for green?

Dr Carney: These are hugely important issues. You rightly raise British leadership in wind and in a host of the technologies, including, for example, artificial intelligence and the application of artificial intelligence to grids, servers and so on for optimising. That is world leadership here in the UK, as you know.

Of course our interest in this is governed by the remits of the various policy functions. From an MPC perspective it does not really enter into the thinking because the policy horizon is short enough that the payback from this expertise or the consequences of climate change, the bigger impacts, are beyond that three-year horizon. For the Financial Policy Committee it is a different story and from the PRA's perspective it is a different story because we regulate the fourth-largest insurance sector in the world and the most sophisticated reinsurance market, I would argue. The physical impacts of climate change are real for those sectors and so we have to care about it.

The big issue that I think we have helped to bring centre stage has been around transition risk. As policies come into play and as new technologies come into play, are our businesses, whether they are in the financial sector or not, well prepared? What is the impact on them? The solution that we have offered through the FSB and the G20, endorsed by leaders, has been better climate disclosure. This is an area, if I may say, that the UK is leading in. Top six banks have signed up, our biggest asset managers, the big pension funds, the big insurers, a lot of the expertise is here, and partly because of that UK leadership there is now \$90 trillion of assets behind this initiative for better disclosure globally. That is potentially going to make a big difference.

However—I will finish here—to go back to your policy point, the impact is contingent on what happens with the overall policy framework because



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that is what the investment responds to. The investment is looking for the information and will react with much more speed and purpose if the policy framework changes.

Michael Saunders: Can I add something? We have talked quite a lot about what Brexit might mean for the economy going forward, but a point that you make, and it is a really important one, is that there are a whole series of structural changes that are happening in the economy anyway, in the labour market in the shifts in the patterns of consumer spending, in new technology and in environmental policy and these affect the economy. I and the others all spend quite a lot of time talking to businesses in all sectors and all regions of the UK in order to get a better understanding of all of these things. We do try to allow that to inform our policy decisions. It is not that our remit is to make those changes happen, but since they are affect the economy we do try to incorporate them.

Chair: That is very helpful. I thought your question about Simon Cowell was a reference to your chief economist, who was going to use Spotify to look at the nation's psyche and wellbeing, but I was mistaken. I was not sure where you were going with that.

John Mann: I was watching you, Chair, all the time, yes.

Chair: Very sensible. Can I thank you all very much indeed for giving evidence this morning? We are very grateful and I am sure we look forward to seeing you soon. For now, thank you very much.