Treasury Committee

Oral evidence: Re-appointment of Ben Broadbent as Deputy Governor for Monetary Policy, Bank of England, HC 2294

Tuesday 11 June 2019

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Watch the meeting

Members present: Nicky Morgan (Chair); Rushanara Ali; Mr Steve Baker; Colin Clark; Mr Simon Clarke; Charlie Elphicke; Alison McGovern; Wes Streeting.

Questions 1 – 69

Witness

I: Ben Broadbent, Deputy Governor for Monetary Policy, Bank of England
Written evidence from witnesses:

CV, Questionnaire

Examination of witness

Ben Broadbent

Q1 **Chair:** Thank you very much indeed for being here for your reappointment hearing as Deputy Governor for the Bank of England for Monetary Policy. I am going to go straight in. Thank you very much indeed for filling in the questionnaire for us as well.

One of the criteria that the Committee considers on appointments obviously is about personal independence: whether the appointee is obviously an internal or external member. In several of your answers, when you were asked for a view, it does start "In the MPC's latest projections" or "In the MPC's most recent forecast". Do you feel that you are able to offer some of that independence of thought to the MPC when they are making decisions?

Ben Broadbent: Yes, absolutely. If I disagreed with the MPC's view, as I described in the answer, I would have said so. The reason I describe the answers in that fashion is that in those cases I agreed with it.

Q2 **Chair:** How robust is discussion with the MPC? Should we be worried about group think at the MPC? I think there is always a belief that potentially the financial crisis, if not caused by, was certainly made worse by group think around boardrooms. Is there a risk of that happening in the MPC?

Ben Broadbent: I do not think so, no. As you know, I have been both an external member and now Deputy Governor for some years. I have been to a lot of MPC meetings. I can tell you that they are pretty robust and open and there is detailed discussion of many issues where each member is able to give his or her view very freely.

Q3 **Chair:** Are there any examples where you have, even now, a personal view or you have examples where you have expressed a personal view that has perhaps been different from other MPC members or even from the majority MPC view?

Ben Broadbent: I think there are always such things; always. In the questionnaire—and I actually touched on this with Michael—I talked a little about the tensions as I see them, as they are in the current forecast, between the assumptions that we make about Brexit and those that might be embodied in some market prices. I do not know if I feel exactly the same way but I certainly have my own views on that. There is sometimes I think, if I may say so, group think about group think. I don't see the evidence that it is there, having been on this Committee for many years now.

Q4 **Chair:** Obviously, the Bank is about to have a change at the top and this Committee will have a role obviously in a pre-commencement hearing. What do you think the priorities for the next Governor should be?

Ben Broadbent: The Bank's remit will not change. As Michael Saunders just told you, it is very clear. That will always be the centrepiece for whoever is Governor, to use our tools to maintain financial stability and to meet the target for price stability as defined by the Government. That is right at the core of what we do and those things will always be the number one priority for whoever is leading the institution.

Beyond that, I would expect the next Governor to continue to make all the efforts that the current Governor has made to—if I can use the word—"modernise" the institution in many ways. It is those core remits, which are given to us by Parliament, which must be right at the centre and must be the number one priorities for the institution and for the Governor in particular.

Q5 **Chair:** How important should diversity be for the next Governor? I think as Deputy Governor you have worked to create diversity in how the Bank works. We saw the BAME numbers last week, I think, in terms of employees. Clearly there are challenges.

Ben Broadbent: Yes.

Q6 **Chair:** What are those challenges? What are the priorities?

Ben Broadbent: As you know, the priorities are to continue to improve female and minority representation at the Bank, including in senior roles at the Bank. I say "continue to improve" because there have been really material improvements in the last few years. I think the number of senior women five or six years ago was 16% or 17%. It is now 31%.

Minority representation in senior roles is the most challenging target. That has gone up but from a very, very low number, 2%, to a number that is still very low, which is 5%, and we clearly have more to do on that and I think it will take some time. If you look at the latest flow numbers, as opposed to the stock, they really are significantly different. Half our graduate recruits last year were female, and 39% of our job offers this year to graduates were to minority applicants. It remains to be seen how many of those choose to accept those offers, but we have made really material improvements.

As you say, there are some areas—clearly, many areas—where we have to make further improvements. I suspect that may take longer in some cases than we have given ourselves, but the changes that we have seen already have been pretty material, which is good.

Q7 **Chair:** You mention the word "modernisation". What does modernisation for the Bank of England—which is hundreds of years old—look like?

Ben Broadbent: That is part of it. There is now an executive committee at the Bank, which there wasn't when I first arrived. There are clearer lines of accountability. There are fewer ad hoc committees. There have been—and will continue to be made—improvements in our central services in the way we purchase things, so that sort of thing: the operational running of the institution, the improvements in its diversity and its internal accountability processes.

Q8 **Chair:** In your questionnaire you were asked at the top whether you intend to serve out the full term for which you have been re-appointed. No intention to apply for the vacancy at the top?

Ben Broadbent: As you know, I am here for my re-appointment as Deputy Governor and in time you will have an opportunity to question whoever is chosen as the next Governor.

Chair: I shall not press you. We will wait to see who the names are on the short list.

Q9 **Colin Clark:** To what extent has the recent 'gating' of Neil Woodford's funds raised financial stability questions?

Ben Broadbent: I do not think that actual event has had much effect on systemic risk. We have not seen spillovers to other funds. We have not seen spillovers to financial markets, so far as we can tell.

You may have read a speech the Governor gave last week at the G20, which highlights arguably some of the issues that are clear in the Woodford episode, namely, the risks involved in maturity transformation in these investment funds. In other words, in having assets for the investor's liabilities for the funds that are more liquid that can be withdrawn at short notice than the underlying assets in which the fund invests.

That is something that certainly the Governor in his role as FSB chair has been focused on for a number of years and so has the G20, so is IOSCO, which is the community of securities regulators. In terms of the systemic effects of the Woodford episode specifically, I do not think we have seen any really.

Q10 **Colin Clark:** What would create financial stability risk around fund gating?

Ben Broadbent: To be clear, as you know, suspensions are allowed and, indeed, I think fundamentally if you have a fund, as I say, whose assets are less liquid than their liabilities there will be episodes when that is probably the right thing to do. I do not think we should see this as an inherent problem or something we should get rid of. I don't think that is the case.

Indeed, I would say that the real financial stability risk in some ways would come from funds having to liquidate assets very quickly at values that were well below their market price. That is precisely what suspensions are designed to prevent, so I don't think I would say 'gating' is the source of the problem. In some ways, it is a reflection of this liquidity mismatch.

Q11 **Colin Clark:** *The Times* wrote yesterday, "When the salesmen get greedy and regulators get lazy—we are playing in a rigged casino". Why would *The Times* personify it as that? It is obviously trying to portray that there is something unreasonable going on.

Ben Broadbent: Yes.

Q12 **Colin Clark:** In terms of financial stability, do retail investors understand what fund gating is? It looks to them like you are closing the door after the horse has run off.

Ben Broadbent: This is the fund's decision. When you say "we" it is not our decision and, indeed, the Bank of England does not regulate these funds as you know. It is important that investors understand that this is a possibility. I think that is important.

We saw a couple of episodes after the referendum when similar things happened in commercial property funds, certainly open ended funds clearly had this structure where you say to the investor, "You can withdraw your money at a day's notice, but you are investing in something, an asset that cannot be liquidated except over long periods of time". There were suspensions of a couple of those funds at that time, so as I say I think the possibility that there will be is always there and it is important for investors to understand that.

Q13 **Colin Clark:** As you have just said, funds are solely regulated by the FCA. I don't know whether this is within your scope but does the FCA have the teeth or resource to prevent scandals rather than investigate them after? Does the retail investor not expect the FCA to stop financial scandals rather than simply investigate them after?

Ben Broadbent: Responsibility—if there is any—for the underperformance of this fund is for the people running the fund. You cannot have a system where regulators collectively could reduce all risk to zero. I do not think that is possible and I do not think it is desirable. There is risk in these funds. There is risk in risky assets. Investors get paid higher returns—sorry, at least an expectation for these higher returns.

As I understand the particulars of this case, there were some questions about whether it could or should have been able to list some of its securities to meet the regulatory requirements, under which no more than 10% of its assets could be held in unlisted securities, but there were no rules broken so far as I understand it.

Q14 **Colin Clark:** Specifically on that point, again, *The Times* referred to illiquid assets being listed on the Guernsey Stock Market to get around EU regulation, and the FCA did not step in or the FCA did not point this out. Is that its responsibility? Is it the FCA's responsibility to identify it is illiquid?

Ben Broadbent: I am not going to answer questions about the individual regulators. One, it is the FCA's responsibility but, again, as I understand it, that was within the rules, so there may be a question about whether investors are sufficiently aware of those rules but, as I understand it, I do not think—

Q15 **Colin Clark:** You see what I am getting at that at some point this Committee will take evidence from the FCA, and retail investors expect the FCA to be providing a function to protect them as opposed to simply investigate after there has been a scandal.

Ben Broadbent: No, I understand, but we should be clear that what individual investors seeking a higher return than in their bank account cannot be protected against is underperformance of that fund. That is the ultimate thing against which it would be nice to have protection, but you cannot. One should be clear that the regulator could never be and should never be seeking to reduce all risk to zero. That cannot and should not happen. As to whether the particulars in this case were met or there should have been more information or the FCA should have—that I will not comment on.

Q16 **Wes Streeting:** First, I want to turn to an issue we have visited on more than one occasion about the relationship between the different policy Committees. In your written questionnaire, you say, "I think the interactions between [monetary and prudential] policies are often overstated, particularly in small open economies like the UK", and you point to a speech in which you argued for a “separation of powers”. Given this, what do you see as the costs and benefits of having the Governor and three of the Deputy Governors across all three policy Committees? Is there a risk that monetary and prudential policies are insufficiently separated?

Ben Broadbent: One is trying to strike a balance. There is a very clear advantage, I think, in having all these committees have the same understanding, or the best possible understanding, of how the economy is doing, where the risks are coming from. To that end, it helps to have people who are members of all of them.

I do think on the other hand—as I said in the speech—that it is important not to meld them all together into one grand committee, where I think what you would end up with there is that people would naturally tend to focus on satisfying the most visible objective. In the case of the MPC and the FPC, that would be inflation, to the neglect of financial stability issues. There is a balance to be struck; I think it is reasonable at the moment.

Q17 **Wes Streeting:** In practical terms, can you think of a circumstance where it would be appropriate to abstain from a vote or recuse yourself from discussions because of your role as Deputy Governor for Monetary Policy having conflict, for example, with the optimal decisions for the FPC or PRC?

Ben Broadbent: If I can separate the two, the intrinsic connections and interactions between monetary and macroprudential policies I think are generally overstated. During the financial crisis when UK-owned banks lost untold fortunes—some measures say £200 billion, in that order—the vast majority of those losses did not come from assets in this country. About three-quarters of them were on overseas assets. Of the rest of the domestic assets, most were in things like commercial property that were not the most sensitive to domestic interest rates. My view is that the idea, for example, that you could have materially reduced the risk or the scale of the financial crisis, the scale of the effects of the crisis seen in this country, by rising domestic interest rates ahead of it, would not have done much.

Maybe it would have made more difference if the Federal Reserve had had higher interest rates and it certainly would have made more difference if the banks had had more capital, but that is history now, as we know. My point is I would not expect to find myself in a position where somehow I would have the incentive to do one thing on the FPC but it conflicts with what I am doing on the MPC. Each committee has its objectives and I think it can largely meet each with its own tools.

Q18 **Wes Streeting:** Finally on this topic before I move on to a slightly separate issue, in your questionnaire you say that there is scope for the FPC, when dealing with macro-financial stability, coming into conflict with the PRA and PRC, when dealing with the prudential regulation of individual firms. Can you cite any specific occasions where this has happened to date?

Ben Broadbent: No, not really. I was thinking more conceptually of what might happen, in particular, in a downturn. One of the fundamental purposes of macroprudential policy is to ensure that in such circumstances banks do not try to maintain their capital ratios by cutting back aggressively on their lending. That is why we ask them to hold more capital. It is why we want other loss-absorbing liabilities. When such a time arrives, it will be important to allow some of these buffers to shrink. It was more making sure that at those times the individual regulators who might be inclined to maintain capital and the macroprudential people who want to release it, that that conversation is clear and the objectives are well understood. Thus far, having been on both Committees for a while, I have not come across—of course, they work together every year in formulating and analysing the stress tests.

Q19 **Wes Streeting:** Turning to the issue of Brexit and business investment now, were you surprised that the most recent data published by the ONS showed business investment in the UK rose by 0.5% in the first quarter of the year, whereas it had declined in all quarters of 2018? What do you think is going on? Noting in your annual report to us you indicated that the upturn in business investment could have been due to, "Precautionary spending on stocks ahead of the presumed Brexit date on March 29", why do you think stockpiling would show up as business investment?

Ben Broadbent: I would say it is related to that. Firms buy stuff that is durable. Some of it is called stocks and some of it is called fixed capital and that is what is recorded as investment when you spend on that stuff. It is possible that there was more spending, say, on warehousing. That is very clearly fixed capital; that is investment. In that case it would have arisen from the same fundamental source, a desire to prepare ahead of 29 March. In that particular case it would have been fixed capital. Having said all that, we should recognise that these numbers, particularly from one quarter to the next, are pretty volatile and subject to revision, so I would not want to over analyse or interpret the first estimate of a move in a particular quarter.

Q20 **Wes Streeting:** Fair enough. In a recent speech, you argued that firms postponed irreversible business investment as the possibility of a no deal approached in the spring. Do you have an estimate of how much business investment may have been forgone?

Ben Broadbent: No, but Michael described to you how our figures look in comparison with other advanced economies. He has a speech today or tomorrow and he has a very nice little graph that demonstrates very clearly and very starkly what has happened in that respect. We follow the rest of the G7 and business investment is pretty tightly correlated across advanced economies. We follow it up and down and then we get to Brexit and everyone else does that and we do that. That gap is 12% or 13% or 14%. It is very, very big. That sort of order of magnitude, certainly well north of 10%, is the effect of this drag.

Q21 **Wes Streeting:** You have given us something to look forward to when the alert pings into our inbox tomorrow with the speech.
Finally, you acknowledged in your speech that firms that see an upside from Brexit may also be delaying investment amid uncertainty. I think it would be a consensual point—whatever the wider political divisions are—that the uncertainty is not helpful. Does this mean that a resolution of uncertainty in the form of an October Brexit, in whatever form, could boost investment? Do you think that the extension of Article 50 to October was long enough to have had any meaningful impact on investment?

Ben Broadbent: No, not really. No, you are making very long-term decisions. Six months is neither here nor there. My understanding of this, as I have tried to explain it in that speech, is that when we talk about uncertainty we are really using that as a euphemism for downside outcomes. It is very clear in the direct conversations with businesses and surveys and what business organisations have said, that in this particular case that is a no deal outcome for Brexit. Choosing that deliberately may reduce uncertainty. It will not increase investment, at least for those firms that have any connection with trade with the EU, whether directly or indirectly. That is pretty clear.

Q22 **Wes Streeting:** One thing I want to pick up, before handing on the baton, is: how would the economy be affected by entering a post-Brexit transition period in October, versus the impact of any further extensions of Article 50?

Ben Broadbent: There are two things that one would expect to take time. One is the negotiation of the future trading relationship. As you know, there is not one at the moment. There are some words but nothing agreed. Beyond that, normally when you strike any trade deal there is a long implementation period—many years, usually—to allow the economy to adapt in the way that it needs to. I think that would be desirable in respect of the economy, certainly.

Q23 **Alison McGovern:** I want to ask you some questions about the communications of economics and particularly that in your questionnaire response you say that, "Public understanding of monetary policy decisions is critical". In many of your responses so far, underpinning that has been the assumption that it is important that the public understand what is going on our economy, particularly around Brexit and other matters.

I would like to ask you about an interview that you gave to *The Telegraph*, when you were describing the situation that we are in in relation to productivity. You described the period that we are in as "menopausal". We have, "Passed our productive peak, awaiting the invention of new technology". Reflecting on your use of the term "menopausal", do you think it was appropriate and helpful in people understanding the state of our economy that you were describing?

Ben Broadbent: No, not at all. It was awful and it was an awful thing to realise that I had caused people the offence that I did. For what it is worth, I did not actually say that. We were talking about productivity in the 19th century. Not now but in the 19th century. There was a period in British economic history—right in the middle of the industrial revolution—when there was a very protracted slump, which still puzzles economic historians. The point I was trying to make was that it is difficult to diagnose what is going on right now with a great deal of precision, and as an example look at what happened 150 years ago. After a century and a half of thought and cogitation we have not figured that one out and I do not think we should be confident about figuring this one out. That was the point I was trying to make.

For some reason, economic historians have described that episode with the word "climacteric". Goodness knows why. I was trying to define that word, so I did not say the current economy is like that. I know it was reported in that way but that is not what I said. Having said that, to have used the word in connection with any economic poor performance, possibly to have used the word at all, was very insensitive and that is why I felt that I had to apologise immediately, which I did. I can only do that again. The answer to your question is definitely not.

Q24 **Alison McGovern:** The apology is welcome, but given the environment in which you work, the Bank of England, one that is utterly dominated both historically and today by men, and you have mentioned that you do not think that group think is a problem, reflecting on that incident do you think that, perhaps unwittingly, you have demonstrated that the Bank of England does still have cultural issues in relation to women?

Ben Broadbent: Possibly, but this was me. I do not think you should draw lessons about the Bank of England from this. It was my responsibility. I said what I said. It should not reflect on the institution.

Q25 **Alison McGovern:** How does the Bank monitor the public understanding of its work?

Ben Broadbent: We have a survey we do regularly, the Inflation Attitude Survey, which asks people about the things that are most important to us—most important to the MPC, certainly—and we have occasions surveys of public awareness. There are others not done by us as well. We look at these things very regularly to try to understand how we can improve our communication and reach more people.

Q26 **Alison McGovern:** Do you think the public understands what it is you do?

Ben Broadbent: Some of them. I do not think everybody does. Let's be clear that the importance that I refer to in the answer was not for its own sake. The reason is that we are better able to control inflation when people understand and trust the target that we are aiming for. That is the core point.

It is to that end that we want to ensure people are aware not of every aspect of what we do but, broadly speaking, first, that we have a 2% inflation target and that we will do what is necessary to meet that; secondly, not at all points of time, what that might imply, given everything else, at least qualitatively for the path of interest rates. That is it. Getting those messages across is important, all the other detail less so.

Q27 **Alison McGovern:** I would have to say I would bet that members of this Committee have probably knocked on more doors and spoken to more members of the public that you have, Mr Broadbent.

Ben Broadbent: Quite possibly.

Q28 **Alison McGovern:** Unfortunately, they do not have a high level of trust in us or you, so I think we have long way to—

Ben Broadbent: If I may say so, the level of trust in our surveys is quite good, so I do not think that is fair and I do not think that is true. If you look at the surveys on trust in the Bank of England, they are quite good. I accept the point that many people are not sufficiently aware, I would say, of the target, what it is for, why it matters, why it is there, but trust, I would dissent from that.

Q29 **Alison McGovern:** You point also to community forums and citizens' panels as examples of growing public outreach. Could you say what you mean by "citizens' panels" and what you think you have learnt from them?

Ben Broadbent: They are a means of talking to people. People are free to come to these meetings, wherever they are. I have done a couple. There are very broad topics that we invite people to have opinions on. There is usually a host who asks questions and then we go and sit at tables and talk to people. They might ask us about anything. It is mainly for us to listen to what people's concerns are about the economy, broadly, but also to try to help people understand what we do and what we can do, what a central bank can do.

Q30 **Alison McGovern:** Do you think that at those citizens' panels people are able to understand the work of the MPC, what it does, or are you mainly there to mutually hear the topics that people raise when prompted?

Ben Broadbent: Both, really; both. I think people are able to understand, yes. Certainly, people who are old enough—as I certainly am—to have lived through the 1970s and 1980s will understand the costs of having very high and variable inflation, very clearly. It is not difficult to convince those people of the virtue of having low and stable inflation.

Q31 **Alison McGovern:** Are they bothered about other issues now?

Ben Broadbent: Yes, often. They will ask about whether the financial system is safe and what are we doing with that. They are very interested in changes in the forms of money we use and how we transact, a whole host of issues, yes.

Q32 **Alison McGovern:** To come on to the FPC's work, your colleagues on the FPC also have an interest in this. They may or may not feel that their work in making sure that the financial system is safe is important to the public. Post-2008 do you think that the public—you say that the public trusts you. What is your evidence?

Ben Broadbent: There are surveys. I can give you the numbers because I know they are reasonably good. I will get those to you.
The answer I wrote about the FPC is not so much about trust but it is about awareness of some of the decisions that the FPC takes and why. Back in 2014 the FPC made various changes to reintroduce more stringent rules for being able to get a mortgage, and I think those have had some effect. With good reason those measures were instituted. It is important to understand that they exist and why those measures were taken. What I would be concerned about is if the FPC took decisions that did affect somebody and they were unaware of the context of those decisions and why they were taken, so I think it does matter to that extent.

Q33 **Alison McGovern:** My final question is: reporting of your work on either of the Committees. It is fashionable to be critical of the MSM, mainstream media, even if it is perhaps, in our position, unwise. What do you think of the way that your decisions are currently reported?

Ben Broadbent: Maybe it is a more febrile environment for news coverage in general, but it is up to us to get our message across in as clear and a consistent way as we can.

Q34 **Mr Simon Clarke:** Mr Broadbent, looking at the world economy at the moment, one of the most pervasive themes is that of trade wars, actual or potential. What is your assessment about the current state of the world economy and where it is likely to develop in the near term?

Ben Broadbent: Clearly, globally, growth is weaker than it was, certainly in 2017 and early last year. Part of that reflects the profile of US fiscal policy and to that extent was reasonably predictable. There was a big boost in 2017-18 and that is now starting to fade. I think there has been an effect of trade tensions, particularly those between the world's two biggest economies—the US and China—and it has contributed to more fragility in business confidence, and reduction in actual trade flows and some weakness in business investment, including in Europe over the last year.

Q35 **Mr Simon Clarke:** How concerned should we be about that, looking at it from the perspective of the British economy? I appreciate it is one that, as you say, is somewhat out of our hands.

Ben Broadbent: That is true but it is also true that we are a very open economy, we always have been, and we will always be susceptible.

Always, no matter, I have to say, whether we are without or within the EU. We will be very susceptible to economic fluctuations elsewhere, disproportionately in our nearest and largest trading partners.

Q36 **Mr Simon Clarke:** Is this something that central banks discuss in terms of your international collaboration?

Ben Broadbent: Yes. People always at these meetings discuss the health and the near-term outlook for the global economy. As far as we are concerned in the UK, as you said, we have to take it as a given and it is a backdrop against which we form our projections for economic growth here—an important part of that backdrop—and through that an influence on policy. Directly, the MPC just has to accept that that is the case.

Q37 **Mr Simon Clarke:** Indeed. We were talking about surveys earlier. To what extent of those surveys show firms reappraising their supply chains in light of some of these tensions, if at all?

Ben Broadbent: There is some tentative evidence—more from Brexit I have to say—that there may be some effect on these chains as the Brexit date approaches and given the ongoing uncertainty about the outcome. That has been cited by a couple of producers of surveys.

Q38 **Mr Simon Clarke:** Are you able to identify what sector they are in?

Ben Broadbent: If you refer to the people who produce the surveys, they are talking about autos, usually. That said, there are other effects on that industry. We know there has been big interruption in production internally at the latter end of last year, dealing with the new emission standards. As you said there are the wider global tensions on trade, so it is difficult to untangle all these effects. We knew ahead of the Brexit process in which of the industries there are these very integrated supply chains and autos clearly is one of the prime examples.

Q39 **Mr Steve Baker:** In a recent paper from the Adam Smith Institute, titled "What a Capital Idea! How to make Britain's banks more competitive, innovative, and safer", John Cochrane and Kevin Dowd argue that, "Prudential regulation fails because it is captured by the banks it seeks to regulate and because it presupposes 'forward-looking' abilities on the part of regulators that do not exist". Are they right that, therefore, the FPC and the PRC are doomed to failure?

Ben Broadbent: No, not at all. The fact that we have capital standards is precisely because we cannot foretell the future. It is an admission of that point. You need capital to deal with unforeseen events. You need liquidity buffers to deal with unforeseen events. It is precisely the admission of that fact that leads to these safeguards.

The banks now in the UK have 10 times the capital they did in 2007[1] and we have simulated a number of times through the stress tests very, very

[1] Dr Broadbent would like to clarify that he meant capital *requirements* are now ten times higher than in 2007.

severe macroeconomic stresses, at least as severe as those in the financial crisis. Perhaps it is surprising but during that crisis the British banks lost, say, 3% or 4% of risk-weighted assets and they now have on average 17% of risk-weighted assets in tier one capital that they pass those stresses.

Q40 **Mr Steve Baker:** I should say I am grateful to the Bank that the institutions engage with Professor Dowd's criticism of those stress tests, but that is rather out of scope for today.

One of the recommendations in the paper is that, "The best system is one of high minimum capital standards and strictly unlimited personal liability on the part of senior bankers, and such a system should not be subject to prudential regulation". What do you think would be the impact of such a system and could such a system be maintained in parallel with the one we currently have?

Ben Broadbent: I would argue we have the core aspects of that. We have a senior manager regime, which has materially increased the liability of individual senior bankers and others, and we have, as I described earlier, large—certainly far, far higher—levels of minimum capital. So far I think the experience of the SMR has been good. It is very hard to say what the effects are.

I cannot tell you that the fact that we have not had another financial crisis in the last 10 years is because of these things but it is unarguable that the levels of capital are much higher. I think it is unarguable, given the stress tests that we have had, that it would be sufficiently high to deal with the kind of macroeconomic stress we had in 2008-09.

Mr Steve Baker: Thank you very much. I will look forward to reviewing your evidence with Professor Dowd.

Q41 **Chair:** Before I hand over to Rushanara, I think we are going to touch quickly on the Mark Zelmer review of the Co-op failure, following on from Steve's question. In his final paragraph he said, "If the UK experiences a protracted benign environment in future, there is a risk that prudential oversight could fade into the background at the Bank of England and receive commensurately less executive attention and resources in an institution where the culture is heavily skewed in favour of macroeconomics". Is that a danger that you recognise? How does the Bank ensure that does not happen?

Ben Broadbent: No. I am Deputy Governor for Monetary Policy but I spend more of my time on macro and microprudential issues.

Chair: Prudential issues rather than the macro economy?

Ben Broadbent: Yes. Not necessary the micro. I am talking about micro and macroprudential together. The number of economists in MA, the bit that serves the MPC, I think is about 80 or 90. There are over 1,000 people in the PRA. Most of the resources of the Bank, most of the analytical core resource at the Bank—rightly, because it is a resource intensive business—are focused on prudential regulation. The three committees have equal statutory footing and certainly the regulatory side has appropriately more resources. I do not think there is any appreciable risk of that, frankly.

Q42 **Rushanara Ali:** I had a supplementary to the point you made about the fact that the Bank of England is 10 times better capitalised since the financial crisis.

Ben Broadbent: The UK banks.

Rushanara Ali: Sorry, UK banks, and the stress testing and so on. Is there a risk that some politicians might seek comfort from that and, therefore, take more risky decisions with the future of the country—particularly in relation to Brexit—than they might otherwise have done if we were not as well prepared as we now are, in your view?

Ben Broadbent: It is our job to do the best we can to make sure that the financial system is robust. It would be a perverse thing, I think, to make the system less robust in order to have some effect of political decisions.

Rushanara Ali: No, I agree, because politicians might be responsible; absolutely.

Ben Broadbent: We are confident—having gone through everything we can—that, as Michael described it, the financial system would not amplify the stress of actual Brexit in whatever form it took. Equally, as Michael also described very well to you, that is one part of the economy. It is not sufficient. Even what other parts of the economy have done is not sufficient to prevent the likely negative effect of such an outcome.

Q43 **Rushanara Ali:** Yes, and they need to heed that. Thank you. At the last "Inflation Report" press conference the Governor emphasised that—according to your forecast—meeting the MPC's inflation remit would require more interest rate increases than the market currently expects, but there was little response from the market. Why do you think that was, and in general how well do the markets understand the MPC's communications?

Ben Broadbent: I think the markets understand them very well, but that does not mean they have to agree with everything in the forecast. The markets will take their own view.

Q44 **Rushanara Ali:** What sort of quandary does that put the MPC in if you are trying to get a message across?

Ben Broadbent: As Michael said, I am not particularly exercised that the future path of interest rates and markets should be exactly the one within our forecast option and it meets our objectives. That does not concern me very greatly. The primary purpose of the "Inflation Report" is to explain today's decision, what we have just done and why. It is not to fix some part of future interest rates.

Q45 **Rushanara Ali:** If there is a regular response from the market to this kind of message, does it generate concern or would it generate concern?

Ben Broadbent: No, I do not think so. It is very rare. I can think of one particular time—and it was not even when I was on the MPC, it was in my previous job—when I perceived the Committee as saying very deliberately—actually, there has been one in my time. A month before we raised interest rates in 2017 we were pretty blunt. On that occasion, you are right; I do not think the market had taken everything on board. Normally, I at least am not trying to say this should be the expected rate in two years' time in fixed-income markets. That is not what I am trying to do. The purpose of the report is to explain today's decision in the context of the forecast. Beyond that, it is to give some idea to people of how we might react in future to particular events.

There was a conference—I am not sure if it is still going on—last week in the US about the Federal Reserve, which the Federal Reserve itself organised, a very big conference and big overview of its objectives and its tools and how it communicates.

I was interested to see the remarks of J Powell who said at some point—we are talking about the Federal Reserve's so-called dots where the FOMC makes forecasts of various things, including the future policy rate. He said that sometimes that distracts people from the more important thing, which is giving people some information about how policy might react to particular economic events.

Q46 **Rushanara Ali:** You would not advocate such an approach here?

Ben Broadbent: I think there are pros and cons. In the submission I gave you I wanted to emphasise the cons because I think they are not sufficiently recognised. Certainly, what would worry me is that people would see these as some sort of promise or even about future interest rates, when they could not be that and could not even legitimately in my view be described as intentions, even though that is often the way the Federal Reserve's dots are described. They are forecasts and they are subject to news about the economy like anything else.

Q47 **Rushanara Ali:** Moving on, two of your MPC colleagues, Silvana Tenreyro and Gertjan Vlieghe, have broken ranks and said that the likelihood is that an easing of monetary policy is more likely than a tightening in the case of a no deal Brexit. Do you think it is possible or wise to say one way or the other?

Ben Broadbent: I certainly do not feel confident about saying which direction it would go in. Immediately after the referendum—and that is a different thing, obviously, the effects of the referendum were disturbances to people's expectations that might arise from Brexit rather than the actual event—we saw a big drop in business confidence; very big, immediately afterwards. That is why the Committee reduced interest rates in the wake of that in August 2016.

We also saw a big depreciation in the exchange rate that fed through to higher inflation. Because at the same time through the course of 2017 unemployment fell faster than we were expecting, even though economic growth was not much faster than was forecast at the end of the previous year. We then raised interest rates.

In that sense, that event and its various aspects—the hit to business confidence on the one hand but the drop in the exchange rate on the other—were in some sense the cause of interest rate movements in both directions. I do not feel confident about saying in advance, given that you might have both again: one moving the optimal interest rate in one direction and one the other. I am not confident enough about the mix or balance of those to say what the net effect would be.

Q48 **Rushanara Ali:** That leaves households and businesses in quite a difficult position if they are facing a no deal Brexit, doesn't it? Ultimately, you are saying—and it seems sensible—that you do not know which way you are likely to respond until you get closer to the situation.

Ben Broadbent: Perhaps I can come back to J Powell remarks and some of what I said in that submission. The most important thing for people to understand is that interest rates will do what is necessary to meet the objective. There is no time when you can say what that means for interest rates with 100% certainty. You are giving up a degree of freedom if you commit to that path. That is the more important thing. The MPC will do what is necessary to maintain price stability no matter what the economic disturbances are, including Brexit.
Where it is possible, you might want to give some general steer as to the direction of interest rates. The effect of this Brexit shock, both the one we had in 2016 after the referendum but also in the event of a no deal, are quite complex. They are complex. There are lots of things going on at once that they might produce and I think it would be misleading to say we know what the implication for the policy instrument would be. The most important thing it seems to me to understand is that it is an instrument of policy. It is not the aim. What remains stable throughout is the remit, the target and the instrument will vary with whatever shock and whichever direction is needed to attain that objective.

Q49 **Rushanara Ali:** There are different views about how big that shock might be, including among you and your colleagues. In the event of a no deal, how quickly would you expect or need to act to make a decision about monetary policy in those circumstances?

Ben Broadbent: It will be difficult. Again, I would not want to say with certainty it will be this direction. I cannot tell you precisely the date as well. One of the issues we will have to contend with is: was output to weaken or output growth to fall in that event, would it be because of growth demand or would it be because of loss of confidence? In which case, you might expect unemployment ultimately to go up. For a given exchange rate, at least, you might want to ease policy. Or would it be because of supply bottlenecks?

Q50 **Rushanara Ali:** That implies you need some time to look at that.

Ben Broadbent: We may well need some time.

Rushanara Ali: Whereas, a no deal Brexit could happen by the end of October. Those are quite different situations.

Ben Broadbent: Yes, but the best response would be to take that time, if indeed it is necessary. I should emphasise again that—

Rushanara Ali: Even if there was panic?

Ben Broadbent: If there was panic and we saw clear drops in business confidence that would militate probably more in favour of easing. There may be things that we see—if they occur with sufficient magnitude—to which we do respond quite quickly. What I was trying to describe qualitatively is that this is the kind of process we would have to go through, however long it takes, for policy to change.

Q51 **Charlie Elphicke:** Good morning. You mentioned how, on the FPC, you brought in mortgage affordability rules in 2014. You said that was important and the prudent thing to do. Are you aware, though, that it has also created a problem in that there are now 200,000-odd mortgage prisoners who are stuck in mortgages that they simply cannot escape, paying rates of 5% or more?

Ben Broadbent: I do not think those affordability rules are the cause of that. The affordability rules do not apply if you move borrowers unless you increase your debt. If you do not increase the principal on your mortgage, you are not covered by those. You can move an existing mortgage to another lender at a lower interest rate and you do not breach those affordability rules, so I do not think that is the cause of the mortgage-prisoner issue.

Q52 **Charlie Elphicke:** That is not our understanding. Our understanding is the FCA is currently having a consultation—

Ben Broadbent: No, that is the FCA rules not the FPC's mortgage affordability. The FCA ones, you are right, and the FCA is currently consulting on those but I would distinguish the two sets. The FPC's are different. Our rules I don't think—this is my understanding—apply, unless the principal on the loan is increased when you move. The FCA is consulting about its own affordability rules on precisely that issue.

Q53 **Charlie Elphicke:** Why is there a difference between what the FPC is saying and what the FCA is saying?

Ben Broadbent: They are different rules. We are not talking about the same rules.

Q54 **Charlie Elphicke:** Take us through the rules of the PRA, the rules of the FCA and the rules of the FPC in this area. In what ways are they the same and in what ways are they different as regards mortgage prisoners?

Ben Broadbent: For mortgage prisoners I do not think the FPC has any role, those FPC rules. You must talk to the FCA about precisely the rules it has in those areas. There will be some cases where if the debt has gone up sufficiently and the equity in the particular house has gone sufficiently, it will not be possible. That is just a prudential thing to do on the part of the lender. It is not the regulator that has caused that issue, but there may be—

Q55 **Charlie Elphicke:** Why has the FPC said, "It is fine, you can move to another lender as long as you are not increasing the balance", and why has the FCA said—

Ben Broadbent: I do not know, you would have to ask the FCA, but the FCA is consulting on precisely that issue.

Charlie Elphicke: Why is there a difference?

Ben Broadbent: You would have to ask the FCA. We are different institutions. As I understand it, the FPC affordability tests do not prohibit people moving, or at least you are not in breach of those particular affordability rules.

Q56 **Charlie Elphicke:** In relation to the issue about bank interest rates and whether they are passed on to borrowers, you will know the Treasury, through its UKAR division, maintained very high rates for a very long time on the Northern Rock residuary book, which has been quite oppressive as far as the so-called mortgage prisoners are concerned. Do you think that they should have been cutting those rates as the Bank of England was cutting rates?

Ben Broadbent: That is not an issue for me to talk to you about. You would have to ask the people at UKFI. That is not a decision for the macro regulator.

Q57 **Charlie Elphicke:** From the Bank of England stability point of view and the respect for rate setting, is it not troubling that organisations like that, and, indeed, the vulture funds that have been buying up these mortgage books, do not pass on rate cuts and continue to charge around 5%?

Ben Broadbent: Let's be clear. We are concerned with macro issues, whether it is macroprudential policy or the MPC is concerned about the overall interest rate charged on mortgages. Those have not only come down but they have come down faster than bank rate. At a level of the whole economy we have seen the opposite. We have seen the spread between mortgage rates and bank rate narrow significantly over the last five years.

Q58 **Charlie Elphicke:** Does it not trouble you that homeowners in this situation are not seeing those rate reductions being passed on to them, that the Bank of England rate setting is being ignored by a division of the Treasury and by the vulture funds that buy up these books?

Ben Broadbent: As I say, we are concerned with the overall level of mortgage interest rates. It is that that affects the way we do our job on the MPC and the FPC. Those overall mortgage rates have come down faster. It is not for me to comment on the policy of individual lenders.

Q59 **Charlie Elphicke:** So you are happy. As long as you are doing your bit, the FCA can do whatever it likes, the Treasury can do whatever it likes, everyone else can just ignore everything the Bank of England is saying and that is fine?

Ben Broadbent: As I said, everyone else is not ignoring. There is a very tight correlation between bank rate and the overall mortgage interest rate. Indeed, if the two have differed at all in recent years, it is that the mortgage rate has come down faster than the bank rate.

Q60 **Charlie Elphicke:** Do you think that there is a case, from a financial stability point of view, that mortgages as a whole should be regulated—not just the writing of mortgages but the holding of mortgages should be a regulated activity—to make sure that in some cases excessive interest rates are not applied and that people are not stuck in the position that a couple of hundred thousand people find themselves stuck in, namely being mortgage prisoners?

Ben Broadbent: Banks are among the most heavily regulated institutions that there are, so they are regulated, obviously, both from a conduct perspective and from a prudential perspective. You asked about how it affects financial stability. From that perspective, I will say again that what we care about is the behaviour of the system as a whole and the behaviour of the aggregate mortgage interest rate and, as far as the prudential risk is concerned, whether banks have sufficient capital to cover the losses. We are not concerned with conduct issues and policies of individual lenders.

Q61 **Charlie Elphicke:** To pick that up, you say banks are very heavily regulated anyway. That is true, but the conduct of the Treasury does not seem to have been particularly in line with any form of regulation. Indeed, its sales to unregulated funds mean it moves out of the regulatory envelope, meaning that people are put at greater risk than perhaps they might be. Is there not a case for saying that mortgages may only be held by regulated entities not by unregulated entities?

Ben Broadbent: You would have to ask the Treasury about that. That is not for me to say.

Charlie Elphicke: That is not a matter of interest from the point of view of the Bank of England?

Ben Broadbent: Not from a macroeconomic, macroprudential point of view, no.

Q62 **Charlie Elphicke:** Let's turn to cash. Is the availability of cash of interest, from a macro point of view, to the Bank of England or is the Bank of England happy to see it all disappear?

Ben Broadbent: Again not macroprudential, no; not monetary policy. It is clearly an important social issue. It is not our responsibility, as it happens, to ensure that availability. That is more a matter for the Payments Regulator. It clearly matters. There are still significant numbers of people in this country who rely on cash, even some people still without bank accounts. It is an important social issue. Those tend to be the economically disadvantaged or some older people, so I think it is an important question.

Q63 **Charlie Elphicke:** Can I put it to you that maybe the Bank should consider social issues, not just for the 200,000 mortgage prisoners who find themselves very impacted but, also, the availability of cash for the vulnerable, the poor, the rural and the people who struggle to get by, who need the availability of cash? Should not the Bank of England be doing that bit to help make the lives of the least well off that bit easier?

Ben Broadbent: Our responsibilities, in whatever area, our remits, are given to us by you. You ask us what to do and then we do it. It is not for us to claim responsibilities in areas that have not been given to us. It is for others—for the Government, for the Payments Regulator—to determine what is the policy for the country as regards access to cash. I think it matters but it is not my job to go and claim that as a policy.
We are responsible for ensuring that the wholesale distribution system that exists currently works as efficiently as it can. That is important because, as the use of cash falls—and it has been, as you know—that wholesale distribution will have to change. It will have to become leaner, precisely in order to sustain the availability of cash. But to decide that this is a necessary thing, that it is a social good that we are going to promote or ensure, that is not for us to go and claim as a policy.

Q64 **Charlie Elphicke:** Let me reframe the question. You say social good you are not interested in but in financial stability you are, how is it wise to have a society with hardly any cash and put all our eggs in the electronic basket and then there is a massive system outage? From a financial stability point of view, we ought to maintain the availability of cash. Shops ought to be taking cash and it ought to be available to each and every citizen in this country, for the stability of the system, to make sure we do not have that systemic risk.

Ben Broadbent: Let me say again, it is not that I am interested in this or uninterested in that. It is what you have told us to be interested in. It is not our responsibility. I think it matters; I do think it matters. I don't think it is necessarily the case that the answer to the question if a banker cannot—by the way, I do not think that a banker cannot. Banks are far safer than they were 10 years ago. That is indisputably true.

Charlie Elphicke: The TSB might not be quite so confident.

Ben Broadbent: As I said earlier, they have 10 times as much capital in aggregate[2]. Their capital ratios are as about four times as much as they lost in the last financial crisis relative to risk-weighted assets. I do not think it is the answer that the primary tool to ensure financial stability is to make sure people use more cash as opposed to bank deposits. I do not think that has much bearing on financial stability.

I will say it again that I think it does matter. It is an important social issue. It is just not for us—because you have not asked us to do it—to deem that it is a priority for the Government. That is not the way the system should work.

Q65 **Charlie Elphicke:** My final question is: where there is cash, are you concerned about counterfeit notes in circulation as the replacement of the £20 notes approaches, and what is your general view on counterfeit and forged cash?

Ben Broadbent: Always, always.

Q66 **Charlie Elphicke:** Have you detected any more of that lately?

Ben Broadbent: Funnily enough, no. We were prepared for that possibility, precisely because of that. Of course, the reason that would happen, and why you might have expected it to happen, is that the polymer note if it is not impossible to counterfeit is pretty close to it. Not just because it is very difficult to reproduce the actual material but it allows for all these extra fancy security features. That was one of the reasons we moved to it.
The experience of countries who had this substrate, as it is called, had the polymer notes for longer—Canada and Australia. Obviously we are always concerned. We have very good scientists working on fancy new security features and all sorts of things. Funnily enough, I do not think we have detected an increase in what was already a very small number. I certainly feared it could happen but it does not seem to have materialised so far.

Q67 **Mr Steve Baker:** Very briefly, you made the point moments ago that some things are and some things are not your responsibility because you do what Parliament asks you to do. Do you think you have adequate mechanisms for communicating to Parliament whether you have the right responsibilities and how you would like change to be brought about?

Ben Broadbent: I hope so, yes; through fora like this one.

Q68 **Chair:** This Committee presumably has a role in that.

Ben Broadbent: Exactly, a very important role; probably the most

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[2] Dr Broadbent would like to clarify that he meant capital *requirements* are now ten times higher than in 2007.

important. These are very important and at times onerous responsibilities. We do not spend a lot of time asking the question, "What should we do? We do not want this. We do want the other". If I think Parliament asks us to do things that we thought the tools of a central bank—whether it is monetary policy or prudential tools—are unable to do, we would probably say so. Our job is to do the best to meet whatever objectives you set us and not to actively say, "We want this" or "We do not want that".

Q69 **Chair:** Presumably, there is a conversation, whether it is you or the Governor or the House or the Treasury, at various points feel able to say, "This is a developing situation, this is something new. We think now we do—"

Ben Broadbent: Yes, that is true. There will be such conversations after Brexit, for example, about the great body of some of the regulation coming back from the EU. That will be an important issue, you are right. They will be technical issues, some of it.

Chair: We look forward to hearing more about that. Dr Broadbent, thank you very much indeed for your evidence this morning and for the questionnaire that you have filled in. We hope to issue our report shortly.