House of Commons

Treasury Committee

Oral evidence: Bank of England Monetary Policy Reports, HC 142

Wednesday 23 February 2022

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Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Anthony Browne; Dame Angela Eagle; Emma Hardy; Kevin Hollinrake; Siobhain McDonagh.

Questions 296 - 417

Witnesses

I: Andrew Bailey, Governor, Bank of England; Ben Broadbent, Deputy Governor, Monetary Policy, Bank of England; Jonathan Haskel, External Member, Monetary Policy Committee; Silvana Tenreyro, External Member, Monetary Policy Committee.

Written evidence from witnesses:

MPR0009 - Jonathan Haskel

MPR0010 - Ben Broadbent

Examination of witnesses

Witnesses: Andrew Bailey, Ben Broadbent, Jonathan Haskel and Silvana Tenreyro.

Q296 **Chair:** Good morning and welcome to the Treasury Select Committee and our hearing with the Bank of England on the Bank of England February 2022 *Monetary Policy Report*. We are very pleased to be joined by four witnesses this morning, who I will ask to briefly introduce themselves.

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

Jonathan Haskel: Jonathan Haskel, economics professor at Imperial College and an external member of the MPC.

Silvana Tenreyro: Silvana Tenreyro, external member of the MPC.

Ben Broadbent: Ben Broadbent, deputy governor for monetary policy.

Q297 **Chair:** Welcome. Thank you for coming in to see us this morning. Governor, could I start with you? "Transitory" is a word that we have discussed many times, including on this Committee, in relation to inflation. In the latest report, the word does not appear, whereas it did appear in previous reports. In fact, in November 2021, "The Committee's central expectation continued to be that elevated global cost pressures would prove transitory". Why has the word disappeared and what do we interpret from that?

Andrew Bailey: The first thing I would say about that is that there was probably a slight concern, not just in this country and certainly speaking personally, that the word was becoming overused. In substance, I would say that, while it is important, looking at the profile of inflation that we have in the February report, it does technically return to target during the third year.

Q298 **Chair:** Given that it peaks at 7.25% in April and is expected to go down, it is still transitory, is it not?

Andrew Bailey: It is. The goal of monetary policy is to bring inflation back to target, so in that sense, yes, it is transitory.

Q299 **Chair:** Why is the word not in the report?

Andrew Bailey: Personally, I must say that it was becoming a slightly overused and, in some circles, over-abused term, and it was important to get more on to what I call the substance of the profile of inflation. The other thing that I would say is that we also have two-sided risks on this forecast. The risks are very important.

One risk—I am sure that we will come on to discuss this during the hearing—is that there will be higher inflation for longer. The other side of the risk is that it will come down faster, which we demonstrated in the alternative scenario.

I can only speak personally on this, and colleagues might want to come in about the use of the word, but I was certainly concerned that it was becoming somewhat overused, not just in the UK. This was going on in some other places and becoming, frankly, slightly over-abused. Certainly speaking for myself, I wanted to get more of the focus on the substance of the profile.

Q300 **Chair:** Some might imagine that it reflects the fact that previous forecasts had proved to be inaccurate in terms of where inflation is heading, and particularly the more recent forecasts compared to the ones further out, and that, therefore, the Bank has finally decided to hedge its bets, because you are less certain about the transitory nature of inflation.

Andrew Bailey: There is a very high level of uncertainty. I will be very clear on that and am happy to talk about that, because we have been hit by shocks—particularly external shocks—that have caused inflation to be higher and to go on for longer than we expected, going back in time. That is true.

Q301 **Chair:** I want to come to Ben, because, of our four witnesses this morning, you are the one who wanted to go further on the interest rate rise, to 0.75%. Is that right?

Ben Broadbent: No.

Andrew Bailey: That was Jonathan.

Chair: I am so sorry—a vile accusation, depending on which way you look at it.

Jonathan Haskel: I am very flattered to be compared to Ben.

Q302 **Chair:** In which case, let me switch to Jonathan. You wanted to go further, which rather implies that you are perhaps more concerned about where inflation is going than some of the others who voted a different way—the Governor and the other members of this panel. Can you just talk us through your thinking there? Are you thinking it will be less transitory than some are imagining or even than this report is perhaps suggesting?

Jonathan Haskel: On the transitory issue, I gave a speech in Glasgow recently and was asked whether I was on team permanent or team transitory, and I replied that I was on team vigilant. As the Governor was just saying, the labels of "transitory" and "permanent" are just not right and they pigeonhole people too much. On that issue, I do not think we need to worry so much about that language.

As far as I was concerned, I put a little more emphasis, in a world which, as Andrew has just said, is extraordinarily uncertain, on some of the forward-looking indicators that we had in front of us. For example, you will know that we run, in conjunction with the University of Nottingham, the Decision Maker Panel, where we ask firms about their intended price increases. That normally runs at a couple of percent; that had gone up to about 4%. That is one forward-looking indicator.

The Bank also has a very good agents' survey of wage settlements, which we run. Again, that normally runs at 2% or 3%; that had gone up to a little higher than 4%. That was a second forward-looking indicator.

The third forward-looking indicator that I thought we should take account of was that the contribution to inflation of service sector inflation was going to rise, according to our short-term inflation forecast.

I gave a little more emphasis on those three forward indicators and, therefore, thought that we should move a little bit sooner. I have to stress that it is a very uncertain situation and a very finely balanced decision. Does that help answer?

Q303 **Chair:** It does. In that speech, you also focused on the tight labour market in particular. Is part of your thinking here that the upward pressures in the labour market might start to get into some wage-price inflation dynamic? I know that we always talk about that. Is that something that you are feeling might be more of a problem, compared with some of the other members of the MPC?

Jonathan Haskel: That is why I was referring earlier on to the notion about being vigilant. That is the important thing. What we do not want is for this blip of high gas prices in particular, and high oil prices possibly coming down the track, to turn into a permanent, embedded form of inflation. If you will forgive me for using a sporting analogy, if everybody at a cricket match stands up, nobody gets a better view. We do not want everybody to be chasing each other, and we do not want all of that to be embedded. I was a little nervous about that.

The speech that I gave, which you kindly referred to, was in the context of November. I will just say that that was in a context where it was extraordinarily difficult to make a judgment on what the state of the labour market was. Unemployment, which is normally a pretty reliable indicator of the pressures in the labour market, was about 4.5%, if I remember correctly, but the number of people in the furlough scheme, even in the week preceding the end of it, was a million. That is a lot of people. What the pressures in the labour market were at that time was very uncertain.

Q304 **Chair:** As things panned out, a lot of these people who were expected to be made redundant were not, and went into the labour force.

Jonathan Haskel: Exactly so, and it is easy to second-guess all of those; maybe we will get into this later on. It is easy to look back and say, "My goodness me. All those furloughed people were reabsorbed into the labour market, so what were you thinking?" but we did not know that at the time.

Q305 **Chair:** Linking your view of where interest rates should have gone to this issue of the labour market, would it be fair to say that you felt we should have had a move upwards in interest rates, because that would have helped anchor inflationary expectations, with the effect of perhaps dampening down some of those wage growth expectations and bargaining and so on? Was that central to where you were in your thinking?

Jonathan Haskel: Indeed; that is nicely put. I would agree with that. We have also been surprised by how tight the labour market has been relative to that very uncertain situation around the time that I made the speech. It has been much tighter than perhaps at least I was expecting.

Silvana Tenreyro: Normally in economics or in the jargon, we talk about transitory shocks that dissipate before monetary policy can have its peak impact. In that sense, we were talking about "transitory". The shocks that we are facing are still transitory in the sense that they are not permanent, but they are slightly more persistent, and monetary policy can do something about that.

Q306 **Chair:** That time horizon on the monetary policy being affected being 18 months to two years—

Silvana Tenreyro: There is a range of estimates in the literature. In terms of the peak impact of monetary policy, the estimates for the latest period would be 12 months to 18 months. That is the peak impact, so that is the reference point for transitory or not. In the English sense of the word "transitory", this is still a transitory shock, in the sense that it is not permanent.

Andrew Bailey: I just wanted to draw on a point that Jonathan was making about the distinction between voting for 50 and voting for 25, and to make a point from my point of view. It is important not to put too much emphasis—and Jonathan was not, by the way—on whether we took a different view on the level that we expected to get to as opposed to the pace with which we get there.

Certainly from my perspective, there was a genuine and a good difference, and an exchange of views, on whether it was sensible to move by 50 in one step now, which would give a stronger signal, or to go in more graduated 25s, which then allows you to see what happens, as it were, before you take the next decision. That was a genuine difference of view within the committee, but I just want to emphasise that point. It does not, of course, necessarily mean that we take a different view on where we get to eventually.

Q307 **Chair:** Ben, did you want to add anything to this? Sorry, I cut you off earlier.

Ben Broadbent: No, that is fine. I was going to say more or less what Silvana said. One of the problems with the word "transitory" is that there were a lot of different interpretations developing as to what that meant. The fact that we have these even further increases in the price of gas and other tradeable goods does not somehow mean that, suddenly, nothing is transitory anymore.

As Silvana pointed out, what we meant by that word was a much longer horizon. The relevant thing is whether the underlying shock lasts long enough for you to have to address it with monetary policy. The orthodox response to, say, a big jump in oil prices is to "look through it", or at least not to respond to it unless it gives rise to the second-round effects on domestic price and wage-setting that Jonathan was talking about.

That is not because we cannot do anything about the global supply of oil, which is obviously true. There are all sorts of things that policy cannot directly affect. It is simply because its influence on inflation does not last long enough to be worth doing something. If the price of oil jumps massively and we were to tighten monetary policy, the direct effect on inflation is gone after a year and policy would not be able to do anything anyway, so all you do is depress the economy in response to a shock that disappears before policy takes effect, which is not really worth it.

That is the crucial thing. Just emphasising what Silvana said, that is the crucial bit of what we understood by the term "transitory": is it still there? Are these price rises in gas and computer chips, and all the things that have been happening through 2021, still going to be pushing up on inflation by the time a policy decision taken now really has an effect? That is the relevant question, not whether they have gone on for two or three months longer than we expected six months ago. That is certainly true, and geopolitical developments have caused even further increases in gas prices, as we know.

Q308 **Chair:** That is clear and helpful. Going back to the domestic price pressures and wage pressures, et cetera, are you, as witnesses today, feeling comfortable with where we are on interest rates and monetary policy in terms of controlling those second-round effects? Whilst I take your point, Ben, about monetary policy being a rather blunt instrument in the context of energy price movements, when it comes to the wage and labour market, it is about anchoring the expectations of where inflation is going. Are you all feeling very comfortable on that point, or are you sitting there feeling that there is a lot of uncertainty around that and that this is a tiger that could escape and cause a major problem? How are you feeling?

Andrew Bailey: I can start on that. I want to make a point that I know goes back to these comments that I have been widely reported on making. It is not just wage-setting; it is also price setting, because it is also company—

Q309 **Chair:** Although you have not stressed the price-setting.

Andrew Bailey: I was asked a particular question at that time, but I want to make clear that, of course, it is both. There is very clearly an upside risk now, which, as Ben was explaining, comes through from the second-round effects. It is quite understandable, of course, that the wage and price-setting process will seek to correct for the very big external shock we have had, and the very big shock we have had to national income, because this is a terms of trade shock. It is effectively like a tax on the UK from outside.

The problem is that, if the whole process tries to do that and tries to offset the shock, then we get the real risk of the second-round effects setting in and we get domestically generated inflation. We are not saying that there will be no pay increases—of course not. That is not what we put in the MPR. We drew on our agents' work, because our agents did a survey of firms' pay intentions at the start of this year. What the agents told us was that there was very clearly an uptrend in that, which was reflecting the evolution of inflation, so we have been very clear that we have taken that into account.

Q310 **Chair:** I know we touched on this point at the last session, in terms of the spill-over of the hot parts of the labour market into a more generalised situation. Is that still the very latest evidence that you are sensing from your agents?

Andrew Bailey: Yes. I did a visit to Wiltshire last week, talking to firms, and the first, second and third thing that firms talk to you about is the labour market and how it spills over into wages and prices. I am not surprised about that. The second-round effects are a real concern. I should say that, if we get the second-round effects, going back to the point that Ben and Silvana made about the potential duration of those effects, we would need to react to that with higher interest rates. Most likely, that would be the consequence.

I have to point out that the consequence of that—and I know I am unpopular for saying these things—is that it would, of course, slow activity in the economy and increase unemployment. As you have probably seen in the MPR, we have a pick-up of unemployment from a low level that we expected to get down to just under 4%, which then picks up to about 5% in our projection. In a world where we had to do more on monetary policy, the most likely outcome would be that it would get higher.

I have to be honest—and we may come on to this: the consequence of both higher inflation and higher unemployment is that it is those less well-off in society who lose out more. I understand the consequences and the unpopularity of what I have said—and it does apply to price-setting as well—but these points have to be said.

Q311 **Chair:** In terms of the links between wages and inflation, productivity is very important, and that has swung around during the crisis, as you would expect, in both directions. What is your assessment of where productivity is likely to settle as we come out of here? What do you think the crisis itself might have done to productivity? It is a very difficult question.

Andrew Bailey: That is a really good question. Jonathan is a real expert on this subject. I am sure that he will want to come in. One of the big questions for us is what the impact of the changed ways of doing things in the economy on productivity is going to be. There are a range of views on that. I do not know if you want to elaborate on that.

Jonathan Haskel: Andrew is absolutely right. What we have seen in the very short run is an enormous change in productivity, essentially because some sectors of the economy have been closed down—social sectors, broadly speaking—and others have stayed open. Unusually in the evolution of productivity, the structural change in the economy has entirely driven productivity. That is why it has gyrated and then come back again.

As you say, Andrew, the key question is what kind of structure of the economy we see in the future. I will try to give you a short answer. If we get some movement towards a more digitally oriented economy—perhaps more online shopping and more remote working—there are some tremendous productivity opportunities, because we can then bring the power of the information technology revolution to areas like remote healthcare and others like that. That will be reasonably promising in terms of productivity.

There were some straws in the wind there in the sense that investment in software and other types of intangibles has just about held up over the pandemic. It has not fallen as much as other types of investment, and there is a little straw in the wind that firms that have managed to keep going during these terrible times may be moving towards that more digital, online, intangible area. That might be some promise for productivity. Ultimately, it is going to be the investment decisions of firms and which way they decide to go that is going to be really important.

Q312 **Dame Angela Eagle:** I want to carry on talking about wages for a bit and then about QE turning into QT. First things first: can you tell me what the median annual pay for a full-time employee was in the last year to April 2021?

Andrew Bailey: I think the average is somewhere in the upper £20,000 range.

Q313 **Dame Angela Eagle:** £31,285. Can you tell me what the median care worker wage was during the same period?

Andrew Bailey: I know it is considerably lower. I cannot tell you exactly what it is, I am afraid.

Q314 **Dame Angela Eagle:** £9.01 an hour, and 77% of care workers are paid below the Living Wage Foundation rate. What was your pay over the same period?

Andrew Bailey: Substantially higher.

Q315 **Dame Angela Eagle:** What was it, Governor?

Andrew Bailey: It is somewhere over £500,000. I cannot tell you exactly what it was. I do not carry that around in my head.

Q316 **Dame Angela Eagle:** Including pension, I think it is £575,538. Without pension, £477,000. That is how many more times than the average pay?

Andrew Bailey: It is substantially more. I know that.

Q317 **Dame Angela Eagle:** Do you recognise the ONS figures showing that real average earnings are now at the same level as they were 14 years ago?

Andrew Bailey: Certainly, the labour share in the economy has not changed much in that period.

Q318 **Dame Angela Eagle:** Do you think that, in these circumstances, perhaps your emphasis on telling workers that they had to show pay restraint was the most important thing to do when you went on the "Today" programme?

Andrew Bailey: I will come back to what I was saying a few minutes ago and then explain the point. First of all, I am not saying that people should not take pay rises. I did make the point that it was in the context of large pay rises. My concern, as I said earlier, is the second-round effects. If everybody tries to get ahead of the shock that we have had from outside, then we will get the second-round effects and it will get worse. That is the problem.

Q319 **Dame Angela Eagle:** Governor, we have had the longest pay squeeze in 200 years, and real earnings are now at the level they were 14 years ago. If there is never any time when people can have any catch-up, because you are worried about the effects of inflation, are you saying that the share of GDP for labour ought to just remain and just be constantly squeezed down because inflation is a problem?

Andrew Bailey: No, I am not saying that. The labour share has not varied much in the last 20 years, as a share of GDP. I am not saying that.

Q320 **Dame Angela Eagle:** It felt substantial, as we all know, when trade unions were weakened after Margaret Thatcher came into being and after Ronald Reagan took over in America. There has been a ratcheting down of the amount of GDP that is spent on and goes to labour. That is not some natural level. Surely, that is something that, if we want our societies to become socially as well as economically sustainable, we ought to consider putting up again.

Andrew Bailey: I am happy to have that debate, and it is an important debate, but can I just come back to the situation we face at the moment? We have been hit by a very large shock, which is a shock from outside.

Dame Angela Eagle: Yes, I understand the exogenous shock point.

Andrew Bailey: Can I just explain the problem? There is nothing that we can do to offset that shock. I would say that nothing more broadly can be done to offset that shock. That is what we call a terms-of-trade shock. The prices of the things we import have gone up relative to domestic prices.

The risk, as we were saying earlier, is that we then get second-round effects setting in. I just want to reinforce what I said earlier. I understand why what I said about care workers has been misinterpreted, but I say again that the real thing that worries me here is that it is those with least bargaining power in the labour market who lose out in this situation, because you have this shock to national income. I am afraid that it is going to hit us as a nation. In a labour market that operates as a market, which is important, it is those who have least bargaining power who get the worst outcomes in that.

Siobhain McDonagh: Isn't the problem that it does not act as a market? In the case of carers, we see huge shortages—sorry, Angela.

Dame Angela Eagle: Go for it, Siobhain.

Siobhain McDonagh: We see huge shortages. People cannot be cared for. People cannot get places in residential care homes. At the same time, people's income is in decline relative to the costs that they have to pay.

Q321 **Dame Angela Eagle:** And there is about to be another huge decline, given the cost of living squeeze that we know is coming.

Andrew Bailey: I think that what you are saying is that some parts of the market work less well than other parts of the market, and I am not going to disagree with you on that. What we are also seeing at the moment, by the way, is a market that is functioning with more people moving jobs to increase their pay. We are observing that the churn has gone up. In a way, what you are saying is not at odds with what I am saying. There is a real concern here that those with the least bargaining power in the market end up absorbing the larger part of this external shock, and that concerns me.

Q322 **Dame Angela Eagle:** There is no sign of a wage-price spiral at the moment, is there, given that there have been 14 years of stagnation and that real wages are going to decline in the next period, probably by quite a lot?

Andrew Bailey: I prefer not to use the term "wage-price spiral", because it is slightly pejorative that the source of this is always wages.

Dame Angela Eagle: Exactly. That is what I was going to come on to ask you.

Andrew Bailey: That is why I made the point about prices. Our agents are reporting to us—and we are not surprised by this—that companies are now striking higher wage settlements, and that one of the reasons underlying that is what we are observing in realised inflation.

Q323 **Dame Angela Eagle:** That might give people in our economy, which is based on quite a lot of consumerism, more money to spend in the local economy and to be supportive of policy, but it certainly would not happen if you suppressed their wages.

Andrew Bailey: I am afraid that that would be true if real wages were rising. The really hard message in this situation is that, this year, we do not expect that to happen, because of the impact of this external shock and the effect that it is having on inflation.

Q324 **Dame Angela Eagle:** You were talking earlier about making a regional visit. The GMB has invited you to spend a day shadowing a low-paid care worker. You could make such a sectoral visit rather than a geographical visit. Are you going to accept their invitation?

Andrew Bailey: I will certainly go to a care home, yes. We split the country into 12 regions. I commit to going to all 12 of them once a year. We do a range of things in those visits, and I will do that, certainly, because it is an important sector.

Chair: Ben and Silvana might have wanted to come in. I do not want to interrupt your flow.

Q325 **Dame Angela Eagle:** I just want to carry on questioning the Governor. You talked about the profit and the price side. What have you said publicly about companies reducing their price increases, like you have asked employees to moderate their pay demands?

Andrew Bailey: I will say this now: the same point holds for the process of price-setting and for corporate margin-setting; that is the capital share or the profit share. The same point holds.

Q326 **Dame Angela Eagle:** So you would want to see restraint there as well.

Andrew Bailey: In broader economics terms, it is the same point.

Q327 **Dame Angela Eagle:** You can say now, before this Committee, that you would like companies to think about their profit margins and not putting them up too much, and also to think about not raising prices too much.

Andrew Bailey: "Think" is the right word. It is a very harsh and hard message, I know, but I cannot, of course, dictate how people go about this. If the hard message is to have an effect, it is that people reflect on this risk of second-round effects. You are right that second-round effects come from both wages and prices.

Q328 **Dame Angela Eagle:** I hope that employers have heard your messages for them to think about that. What are you going to do about bankers' bonuses? We are just in the middle of a huge bonanza of bankers' bonus pay-outs.

Andrew Bailey: The same point holds. We do not set pay levels in banks. We have remuneration policies that are designed to meet our prudential and financial stability objectives. They are not about levels;

they are about the structure of remuneration and getting the right incentives. The same point on restraint holds for everybody.

Q329 **Dame Angela Eagle:** You want bankers' bonuses to be restrained as well.

Andrew Bailey: All I would say is, "Please reflect on the situation we are in". That would be my point.

Q330 **Dame Angela Eagle:** What about executive pay?

Andrew Bailey: The same point: "When you are thinking about this, please reflect on the economic situation we are in, with this very big shock coming in from outside".

Q331 **Dame Angela Eagle:** Basically, restraint all round is what you are saying, Governor, on all sides of these equations.

Andrew Bailey: I know that others want to come in, but can I just go back to the point I made earlier? This hits the least well-off hardest, so we should think about it in those terms. When I talk about restraint, we should bear in mind that a lot of this is, frankly, my big concern that the least well-off will come off worst in this process, if we do not have some process of thought and restraint in there.

Q332 **Dame Angela Eagle:** Governor, I want to move on to talk about the first toe in the water in converting QE into QT; that is quantitative easing into quantitative tightening, for those who do not know the jargon. Can you take this opportunity to take us through how you see this process, which you dipped your toe into recently, playing through? We are in uncharted waters.

Andrew Bailey: Yes. We have taken the first step, which was the consequence of raising the Bank rate to 50 basis points. That triggered the decision we indicated last August, which was that we would, at that point, cease reinvestment in the gilt portfolio. Indeed, the first reinvestment we will not make is about to happen in the next few weeks.

I would say that, if we stop there, the path down is quite gradual. The reason for that is because we have purchased gilts over the years in fixed, equal buckets of short, medium and long, so that sets the path of maturities.

What we said last August was that, if and when Bank rate reaches 1%—and the words are important here—we will begin to consider active sale. It is not the same sort of quasi-automatic process that we had with ceasing reinvestment, so we will do that when we get to that point. We have not done that part of the process yet, but that is what we will do. The 1% is necessary but not sufficient, and then we would have to consider what the right profile is.

Q333 **Dame Angela Eagle:** What sort of things will you take into account? You have to signal to the market and, although it is not an automatic mechanism, it is important that you do not suddenly change the criteria that you are considering. Do you want to say anything else today about other things that you will take into account in your decision to conclude whether it becomes necessary to do QT rather than not, once interest rates get to 1%?

Andrew Bailey: Yes, I will say a few things. First of all, my view on our intention is that we will do this in what I would call normal market conditions. There is very little experience of QT. There is none here and not much globally.

Q334 **Dame Angela Eagle:** There is virtually none.

Andrew Bailey: It is beginning to grow. If it is symmetric to QE, our view is that QE has its biggest impact in times of market dysfunction. If that is the case symmetrically, we would want to do QT at times of calm markets; otherwise it would have its biggest reverse effect.

Q335 **Dame Angela Eagle:** We all wish for calm markets, do we not, Governor, but we do not always get them?

Andrew Bailey: We would want to have a trigger that controlled that, because we could suspend it. That is important from a monetary policy point of view, because it means that we would want to conduct QT at times when its impact on monetary policy was least. That is my view.

We would then have to work out what we think at the time is a sensible pace for doing it, so we will have to do that. That will involve discussions with the DMO. By the way, in the exchange of letters that you may have seen that I had with the Chancellor, when we started the no reinvestment, we flagged that we would do that. That is important.

The final thing I would say on gilt QT—and this is said quite often—is that we have a very large stock of gilts at the moment. In terms of market impact, it is not correct to think that we would sell the whole lot. I will come back to why I said "market impact" in a moment, because it is deliberate. The reason for that is that on the other side of our balance sheet to the gilts are reserves, which is wholesale central bank money. Banks hold reserves for liquidity purposes. It is the highest-quality liquid asset that you can have. The demand for reserves has gone up since the financial crisis, deliberately, because, pre-financial crisis, the prudential regime was inadequate.

I would say that we know two things. We know that the level of reserves that we have today is higher than the steady state level, and that the level pre financial crisis was way too low and did not consider financial stability. What I might call the equilibrium level is somewhere in between. We do not know where it is, but we know that we will not be reducing and, therefore, selling into the market the whole of the stock of gilts that we have.

Just to be clear, I phrased it in terms of market impact because the second leg of that is, of course, that the way in which the QE portfolio is structured is that it is in the asset protection fund, and the net cashflows go to the Treasury, so there will have to be another leg of this to settle how we end that and shift to a different world where it is part of the Bank of England balance sheet.

Q336 **Dame Angela Eagle:** So far, the Treasury has done rather well out of QE.

Andrew Bailey: In cashflows, yes—about £120 billion.

Q337 **Dame Angela Eagle:** The other side of that coin, if you are doing QT, is that there might be losses. You have had an exchange of letters with the Chancellor about the Treasury always making up those losses.

Andrew Bailey: I go back to Lord King's days as Governor, when they first said this.

Q338 **Dame Angela Eagle:** Does that mean that he is going to be on the phone to you if it is a bit tight in the Budget, saying, "Do not sell any assets at a loss"?

Andrew Bailey: We are an independent central bank.

Dame Angela Eagle: That is partially what I was getting at.

Andrew Bailey: To your original point, that is why it is important to set out the policy and the profile in advance. That is one reason why it is important. The market is obviously important in that respect as well.

What I should say is that it is very reasonable to expect that the cashflows will reverse. Indeed, if you look back at the letters between my predecessors and Chancellors going back to the beginning of this, they anticipated that, because the positive cashflow to the Treasury reflected, essentially, the path of interest rates, which were coming down. When you get the reverse of that, the cashflows will turn round. They will not turn round immediately, because it depends on today's rates versus the rates at which the gilts were purchased, but that will happen.

Q339 **Dame Angela Eagle:** I just wanted to put a quick question to Ben because of the decision to unwind the £20 billion corporate bond QE programme through active sales. The minutes do not explain this decision beyond that it "reflected the specific characteristics of the corporate bond market". Do you want to outline that a bit more?

Ben Broadbent: Only that the maturity of that stock is extremely long, so it would not be possible, or at least practical, to unwind it purely through stopping reinvestment and allowing the things to mature. We have a couple of 100-year bonds.

Andrew Bailey: 97 years.

Q340 **Dame Angela Eagle:** But that is not going to be resolved in our lifetimes.

Ben Broadbent: It is a slightly different means of unwinding than for gilts. The gilt stock has reasonably long maturity relative to other countries, but not as long as that.

Q341 **Dame Angela Eagle:** Finally, these were launched after the Brexit referendum, on the basis that they would offer greater bang for buck than purchases of Government debt. Did they, or is it too early to say?

Ben Broadbent: If you were a sceptical economist, you would need to decide that one way or other, with more evidence than one single episode. At the time, if you look at, for example, the amount of corporate debt issuance after that, it is suggestive that it did have some effect at a time when that market was showing signs of freezing up.

As Andrew pointed out on the side of Government debt, the effects vary according to whether that market is in a liquid state, in which case our buying or selling a small amount probably does not do as much, or whether it is illiquid, in which case, if we come in as a market maker on either side, or we buy and sell stuff, it would have more effects. Our judgment at the moment is that that corporate bond market is working reasonably fluidly, so we do not expect the sale of what is, in any case, a relatively small number of corporate bonds to have much impact.

Q342 **Chair:** Can I quickly go back to you, Andrew, and this discussion about the reverse flow away from the Treasury as QT kicks in? Did I hear you say something around maybe reviewing the way that that was accounted for?

Andrew Bailey: No.

Chair: You were saying something and then you were cut off.

Andrew Bailey: No, not reviewing the way that the asset protection fund works. My point was that, at some point, we are going to hit the steady state stock of reserves, and they have to be matched by assets on the Bank of England balance sheet, which will most likely be a stock of gilts, so we are going to have to find a way—and this is part of the thinking we are going to have to do—to transform that from a stock that is held in the current form, which is indemnified by the Government and whereby the cashflows then go to the Government, to something that is held by the Bank of England, because it is the backing assets for the reserves.

We are going to have to do a number of things at that point, because we are going to have to then find a way to, effectively, transfer the value of that, settle up the estimated future obligations, and work out how we account for that in the Bank of England balance sheet, so we have quite a lot of work to do on that, frankly. I would be very surprised if we hit this level in the near future. We should have quite a long way to go before we get to that point.

My point is not about the accounting for the system that we have today; it is how we move from that system to what you might call a steady state world of the future.

Q343 **Rushanara Ali:** I have some questions for all of you on forecasts and interest rates. Do you believe your own forecasts and, if not, what else is guiding monetary policy? I appreciate that you have touched on some of the issues, but given the rising inflation rates and all that is happening, how much confidence should we have in the forecasts and how much do you have?

Andrew Bailey: I am happy to start off, but I am sure the others will want to come in. It is the central case for us. Let us go to energy prices for a moment, which are a key point. The convention we use for the forecast of energy prices is that we use the first six months of the market and then hold it constant thereafter. The first six months currently is quite flat, and I will come back to that in a moment. It is a reasonably flat profile, although it comes off a little bit. That is one view.

Forecasting energy prices is inherently challenging, particularly in the current environment. We presented an alternative scenario, which took the market price, and this is particularly relevant to gas. You will see that in the MPR. That showed inflation falling faster and going below target.

To your question, which one do we believe? They are both relevant. The way I think about it is this: we have a central case. As we said, we have two-sided risks. We have an upside set of risks, which I would say really now come from two things: one, as we were discussing a few minutes ago, is the second-round effects in wage and price setting. Unfortunately, we also now have an upside risk on energy prices from worse things happening in Ukraine. We have a downside risk going further out, which is the alternative scenario. As Ben said to us many times, energy prices tend to revert to mean eventually. The market takes it towards that, but it does not take it back to the mean.

Q344 **Rushanara Ali:** Does that raise the question that, given this very significant underestimate in terms of inflation this year, and given all that is happening, there needs to be a rethink about how forecasting happens, or is the current mechanism for doing what you are doing fit for purpose?

Andrew Bailey: No, I do not think it needs rethinking, but what I would say—and I speak personally in terms of my own thinking about how I then use that in the interest rates decision-making process—is that the risks at the moment are larger and, therefore, have a larger impact on my own thinking.

Q345 **Chair:** Where you take the alternative modelling, which is where you take the future market prices of oil and gas, et cetera, going forward, after the six months, what has happened to that curve today, given what has happened in Ukraine, and how much has it shifted?

Andrew Bailey: If we go back to the November MPR and we take gas prices, I think I am right in saying that we still had a curve that came well down by the summer. The way I would rationalise that at the time was that we knew that in Europe, gas storage levels were very low going into the winter, so there was a story about a risk to gas prices in the winter, which was amplified by having a low storage level. As you come out into the summer, the price comes off, because you do not need as much gas. That is the point at which they usually replenish the storage.

Unfortunately, what has happened since then is that, to your question, the curve has flattened, in the sense that prices further out have come up a lot. So we now have a curve that does not really come off for 18 months, the last time I looked at it, which was earlier this morning. It has changed a lot. I think I am in right in saying that, between November and February, the summary number for the movement in the relevant parts of the curve is about a 30% increase.

Q346 **Chair:** Would that mean that, under the alternative model, the inflation expectations would now be higher than those where you have—

Andrew Bailey: The February alternative model factored all of that in, because it was the curve as in February. What it means is that the downside risk from prices coming off is being pushed further out. The only reason I can really adduce for this is Ukraine.

Q347 **Rushanara Ali:** The Chair read my mind so well, because I was going to come on to the last 24 hours and the fact that we have had the announcement from the German Government about Nord Stream and the reliance on international energy. Other colleagues are going to come in on the international perspective, but given the even greater external pressures, one of the challenges here is that we have already seen an underestimate in terms of forecasts. How are you going to stay ahead of the curve rather than playing catch-up, which is what some commentators have started to accuse the Bank of being in a position of doing, appreciating the context in which you are operating and some of the things you said earlier?

Ben Broadbent: Can I come in on that?

Q348 **Rushanara Ali:** Can I just get the response from the Governor, and then you are all very welcome to come in.

Andrew Bailey: It is very hard for us to forecast geopolitical events. That is the real problem that we have.

Q349 **Rushanara Ali:** You saw it coming down the line. In fact, you have mentioned Ukraine and geopolitical points in previous sessions.

Andrew Bailey: We use market prices because the markets take that information on board. What we do not have is private information on what Mr Putin may do next.

Ben Broadbent: The market is full of professionals who are extreme experts on the energy market and who are paid to think about developments in that market and what future prices will be. No one could have done better than that market, and that market is miles off in terms of what future energy prices will be.

If you go back to, say, the point at which monetary policy might have been able to do something about gas price inflation and its contribution to CPI, given the lags that Silvana was talking about, to have offset this now, we would have had to have tightened policy aggressively in the summer of 2020. That is the kind of time horizon that you are talking about.

At that time, if you look at what the market was expecting the price of gas to be now—

Q350 **Rushanara Ali:** It would have had to be done in 2020 or even 2021.

Ben Broadbent: Yes, but not only that. If you asked the market what it was predicting the spot price of gas to be right now, the answer is something like 40 pence per therm, and it is now close to 200 pence. We do not forecast that. That is the point I am trying to make.

Q351 **Rushanara Ali:** It is not a personal criticism of you. I am trying to get you to reflect on some of those observations.

Ben Broadbent: I am trying to answer the question specifically about whether we should change the way we do the forecasts, and my answer is no. I do not think that we can do better than to take the market price in general. We do it for the currency, for oil and for gas, and that is the answer to the question. We do not forecast those prices. We just take what the market expects.

Q352 **Rushanara Ali:** There is a broader issue. Again, I am going to play devil's advocate; you will probably not be very happy about it but I am going to say it. There have been some commentators who are arguing that "Threadneedle Street has fallen badly behind the curve, miscalculating the rise of inflationary pressures, and now needs to play catch-up to regain credibility."

Andrew Sentance, a former MPC member, is quoted as saying, "They've sent conflicting messages on monetary policy since last November, and they seem to have lurched from being very cautious to being seen to want to act. But it's still not clear what strategy they're going to be following in the future."

Do all of you feel that there is a strategy? Given all these external challenges, is it even possible, since the pandemic and the Brexit shocks? We have a £20 billion decrease in exports just in the last year; we have Covid and now geopolitical issues. This is not about pointing the finger. It is about just trying to understand whether you feel that you have everything in place to be able to respond to these really huge challenges.

Silvana Tenreyro: You are right. This is a huge challenge. Just to start from the basics, the most straightforward role for monetary policy is in offsetting inflation triggered by demand shocks—shocks that push activity and inflation in the same direction.

At the moment, as well as some demand-side pressures, the UK economy is facing a huge supply-side shock, as you rightly pointed out. Just to be clear, monetary policy can offset the inflation impact of a supply shock if, hypothetically, it knows about it well in advance, as Ben was saying. It cannot reduce the price of energy but, over time, it can affect the prices of other goods and services, so as to hit the target.

The reason that supply shocks are not straightforward and are so challenging is because they create a trade-off for monetary policy. The increase in energy and tradeable goods prices pushes up on inflation but also lowers real incomes and real activity. This creates a trade-off for monetary policy. Returning inflation back to target too quickly destabilises economic activity and employment, reducing output below expectations and causing an increase in unemployment.

The MPC remit is contemplating very explicitly this type of trade-off shocks, and it recognises that, on occasion, the inflation rate might depart from its target as a result of these shocks and disturbances. In those settings, it acknowledges that attempts to return inflation to target might come at the cost of output volatility.

The remit goes even further and acknowledges that in some exceptional circumstances, these shocks might be larger or more persistent, or both. In those cases, the MPC has to manage those and decide upon the speed with which it returns inflation to target, taking into account the costs in terms of output volatility.

The question for us now is how best to manage those trade-offs. Let me just add that these supply shocks are nothing new. In some sense, we were in trade-off territory in the aftermath of the financial crisis and following the Brexit referendum. What is unprecedented, at least in recent decades, is the size of the shock.

Q353 **Rushanara Ali:** Would it be appropriate to characterise what you are saying as that you are basically backed into a corner, given the external points and all that is going on, with limited room for manoeuvre?

Silvana Tenreyro: We need to manage that trade-off in the best way possible. It is a huge shock that is going to have a big hit.

Ben Broadbent: Can I emphasise what Silvana said about the size of this? If you look at the increase in energy bills this year, it is just about twice as big as any single year in the 1970s. It is enormous. That is the challenge, and there is nothing that we can do about that directly, but, as Silvana says, we have to think about the horizon over which that shock peters out.

As for the strategy, the strategy is the same as it was when Mr Sentance was on the MPC. We have a forecast—

Q354 **Rushanara Ali:** When they leave, these people get very vocal, do they not?

Ben Broadbent: What I am saying is that that is my answer to the question.

Q355 **Rushanara Ali:** Is the strategy still fit for purpose, given all that is going on?

Ben Broadbent: Yes, it is.

Rushanara Ali: That is reassuring.

Ben Broadbent: These shocks are enormous. They are even bigger than anything that Mr Sentance faced when he was on the MPC, and we have to manage them in a similar fashion.

Rushanara Ali: He is not going to be invited to reunion parties, is he?

Ben Broadbent: I am just saying that that is one of the key points to get across. It is immensely challenging and it relates to some of the things we were talking about earlier, when we were talking about shares of income and of GDP. This is a huge hit to real national income.

There is a question that we were looking at earlier about why it is that real incomes are weaker than GDP. The reason for that is that real national income—and this does not happen very often—is much weaker than GDP, because the prices of what we are consuming are going up much faster than the prices of what we are producing and selling. That is the nature of this terms-of-trade shock. It is the nature of the huge rise in import prices.

That means that there is a big squeeze on real incomes, and so we are facing a situation that is very clear in the forecast, where, on the one hand, inflation stays high, although not forever, and, on the other hand, domestic spending growth is weakening in the forecast and unemployment starts to go up, which is precisely the kind of trade-off that policy has to think about.

In its nature, it is not different from what we have done, and I do not think that the way we view, forecast or try to manage it with policy should change, but the scale of it is completely unprecedented.

Rushanara Ali: I did say I was being provocative, so thank you.

Ben Broadbent: Indeed, but I was trying to answer the question.

Silvana Tenreyro: Just to add, it is the framework in our remit that is contemplating those shocks. Again, it is the size that is extreme.

Jonathan Haskel: I have one small thing to add, if I may, just to complement Ben's remarks about the scale of it. The share of energy—oil, gas and so forth—is only 6% of the consumption basket, but its contribution to the rise in inflation over the last year is almost 50%. Just a 6% share explains almost half the rise.

Andrew Bailey: More than that in recent months.

Jonathan Haskel: Yes. For the record, that data was for the rise over 2021, but indeed, Andrew, I should say that that is right.

Andrew Bailey: It is about 70% in the first quarter or so of this year.

Q356 **Rushanara Ali:** Given the tight spot that you are in, with inflation being way off target and continuing to go up, is it not the case that this is something where you have limited scope in what you can do and it requires policy intervention by Government, if we want to do anything to address the energy price pressures on consumers? There is not really a great deal, is there, that could be done here, outside of policy?

Andrew Bailey: That is for Government to answer. What I would say, however, is that, as all of us have said during the last period, this shock cannot be hidden away somewhere. It is a shock to national income. It is not for us to say what Government policy would be, but I would simply observe that there is no public policy that can lose the impact of this in that sense.

Q357 **Rushanara Ali:** I suppose that what I am saying is that you are very limited in what you can do here.

Jonathan Haskel: If I can come in here, if you will forgive me, our remit, given by you, is the average inflation rate. You are absolutely right—and Andrew was saying this earlier on—that changes in inflation affect different people at different stages of the income distribution: retirees, non-retirees and all that kind of thing. That is not something for us, although it is very important that campaigners have been pushing away at all of that.

Q358 **Rushanara Ali:** Since the Governor opened up the conversation about wages earlier, I suppose I am taking it as permission for us to think more broadly about the role of Government. I am not asking you to recommend to Government, but this is an issue that is exercising all of us in terms of the impact on citizens. That is an area that Government need to address, if they want to do anything through policy to try to take the edge off the pressure on consumers in terms of inflation and fuel price increases.

Andrew Bailey: I say this as an observation, not as a piece of advocacy, because it is not. At the last hearing that we had, I observed that, if you take the household survey and split it into deciles by income, the bottom decile spends around 7% of its income on energy. That is around twice as much as most of the other deciles. There is really a break in the number at the bottom decile.

Q359 **Rushanara Ali:** That is why we have such a violent reaction—not literally violent—to the comments about wages. People are feeling the pressure of the cost of living crisis and so on.

Andrew Bailey: But that is my concern. Just to reiterate what I said, my concern is that, in a second-round effect process, it is those who have least bargaining power in the labour market who get hit more. By the way, just to add to the observation I just made, because I am afraid that it probably would be concentrated more at the lower end of the distribution, they are spending more on energy. We cannot offset that. I can observe it, but I am afraid that we do not have the tools to—

Rushanara Ali: No, I appreciate that.

Silvana Tenreyro: Related to this and going back to Dame Angela's questions, the Bank of England does not have any influence on how workers and firms share losses or gains. If workers want to negotiate higher real wages at the expense of profits, that is completely independent of monetary policy. Where monetary policy steps in is when wages and prices are accelerating together. That is our role. Distributional issues are for Government.

Q360 **Rushanara Ali:** Yes, absolutely. We will move on to interest rates. We have had ultra-low interest rates for the last 13 years, but with inflation soaring, are we going to see an end of an era, with ongoing interest rate increases for some time to come?

Ben Broadbent: I do not know. I doubt we are going to get back to the levels when the MPC first began 1997, and still less those that prevailed earlier. Ultimately, what is required in terms of the level of interest rates depends on the technical term that we have used of the "equilibrium real rate", which is set in global markets. That has definitely come down. Over a period of many years globally, I would argue, that process has been going on for at least a quarter of a century.

Our understanding of the sorts of things that have probably driven that decline is that they are unlikely to turn around very dramatically—they may at some point—nor are they really connected with the inflation we are seeing right now. We have spent a lot of time talking about energy prices and the prices of other globally traded goods. A lot of that is connected with the pandemic. It has not really done anything to change my view about those longer-term factors.

We have said that we are probably going to need some further gradual and limited rises in interest rates to ensure a sustainable return of inflation to target in the medium term, but that does not mean some inexorable and never-ending rise back to the kinds of levels that prevailed before. That is pretty unlikely. We do not pre-commit to some level and we do not say, "This is where we are definitely going", but if you asked me to guess—we can talk only in very broad terms—it is pretty unlikely that interest rates will have to go back to those sorts of levels that were there 20 or 30 years ago.

Q361 **Rushanara Ali:** People have got used to having low interest rates, so what is likely to happen in terms of the impact on the way that people have experienced it, in terms of mortgages and so on, and how that impacts on the wider economy?

Ben Broadbent: We spend a lot of time thinking about how policy works. I do not see any particular reason to think that these changes will have dramatically more impact than a change would have done two, three, four, five, or even 10 or 15 years ago. In fact, if anything, with reference to some very specific channels like, say, the mortgage market, the process is likely to be slightly slower and more moderate in the first instance. You have to remember that fewer than half of households have a mortgage, and, in terms of those that do, there are many more fixed mortgages amongst that population. They are not fixed for 10 years but they are certainly fixed for two or three years.

Q362 **Rushanara Ali:** So households and businesses that have relied on low interest rates should not have such unexpected surprises or large rises in the coming years.

Ben Broadbent: There will be some. One of the other committees to which Andrew and I belong—the Financial Policy Committee—spends a lot of time thinking about the tail of the distribution and those for whom debt costs, whether mortgages or corporate debt, form a high proportion of their income. There may well be some increase in that population, but overall—and the MPC is certainly concerned more with the "overall"—I do not think that the necessary rise in interest rates will be so dramatic that it takes us back to the levels that prevailed 20 or 30 years ago.

Q363 **Rushanara Ali:** If it is not going to be dramatic, what sort of numbers should—

Ben Broadbent: I am not going to give you a number. Coming back to Silvana's remarks about the remit, the important thing is that we do what is necessary to ensure a sustainable return of inflation to target over the medium term, with least real cost to the real economy. We have talked a lot about the unpredictability of the shocks that come along. It is crucial to remember that our job is to respond to those shocks in as much as they affect our projections for the medium term, and so to pre-commit to some level of interest rates would be the wrong thing to do in the face of all these shocks that come along.

Q364 **Rushanara Ali:** I appreciate that, but given the way in which inflation has come as a big shock, I suppose what I am getting at is that people will want some reassurance that they are not going to see very high levels of interest.

Ben Broadbent: I was trying to give as much as I can, but what I am saying is that I cannot say, "Here is a number beyond which we will never go".

Silvana Tenreyro: As Ben says, we cannot pre-commit to a level of rates. What I can say is that the best thing is to look at our forecasts and the updates to our forecasts. Currently, our forecasts suggest that, if we kept interest rates at 50 basis points indefinitely, that would create an overshoot of inflation in year two of 60 basis points, and in year three of 10 basis points. That suggests that some more really modest tightening would be needed to return inflation to target over the forecast period. That is the range of magnitudes as of now, but of course there is a lot of uncertainty around that. Ukraine, as we just said, is one big factor that might play out.

Just before the pandemic, rates were at 75 basis points, inflation was below target, and unemployment was very low. The labour market was tight, at least in quantity metrics if not so much on the wage side. Many things have changed since then, but not dramatically and, as Ben said, nothing structural is to change significantly, in my view at least. Again, it is important to keep the uncertainty that we cannot give concrete information.

Andrew Bailey: Silvana has said most of it. I was just going to repeat the words that we used in the monetary policy statement: "Further modest tightening is likely to be appropriate in coming months". That is the position.

Rushanara Ali: "Coming months" is the point, is it not? People are thinking, "What is going to happen next year and the year after?" but I appreciate what you are saying.

Andrew Bailey: I would just repeat the words that we used in the press conference that we held when we issued the report. It is a message to markets not to get carried away. It is the same message that Dave Ramsden gave in his speech yesterday.

Q365 **Kevin Hollinrake:** On a similar theme, coming to you, Jonathan "The Hawk" Haskel, on the MPC, you voted for a higher increase than everybody else. How high can interest rates go to reach equilibrium level?

Jonathan Haskel: Thanks for the question. It is similar to what you said before. Ben gave the answer, which is that it is difficult to commit to a long-run path of rates. The equilibrium interest rate, as Ben was saying, determined on world markets has fallen for probably the last 30-odd years, so we are not going to get back to the types of levels in 1997, with the establishment of the committee.

As Silvana has just said, if we keep rates constant, we are going to overshoot the inflation target in both year two and year three. They are going to rise and are certainly not going to be constant in order that we hit the target. To emphasise that, as all my colleagues have said, hitting the target is the most important thing for us.

Q366 **Kevin Hollinrake:** The Bank's analysis in 2018 estimated that the equilibrium nominal interest rate lies between 2% and 3%. Is that still valid?

Jonathan Haskel: It probably is. I do not know that there have been comprehensive recent studies on all of this, but it almost certainly has not gone up relative to that. If anything, it has probably gone down.

Q367 **Kevin Hollinrake:** So you could see interest rates settling at that level at some point over the next few years.

Jonathan Haskel: Again, I really do not want to commit to a long-term path, because I do not think it would be right to.

Silvana Tenreyro: We have not done a new analysis on the equilibrium level of rates. The figure you cite is R*—the long-term equilibrium rate. We also discuss, in the same issue of the MPR, the concept of a short-term equilibrium rate, which is a more medium-term measure. At the time, we thought that it was much lower than the R*. It is more the cyclical component. There is a distinction between that long term, which might be way beyond our three-year forecast period, and the R* for the medium term or the forecast period, which is affected by many other cyclical factors.

At the time we were discussing, it was definitely battered by many factors that were lowering it. That explains why, in the pre-pandemic period, we had inflation at or below target, and unemployment was at its equilibrium rate. There are these two concepts to keep track of: how r*, the short-term equilibrium rate, evolves, and then the long term, which is a more structured variable. As we explained in the report, what drove those changes were demographic changes and changes in productivity growth. Those longer-term issues have not really changed with the pandemic, so those would tend to keep equilibrium R* relatively low.

Q368 **Kevin Hollinrake:** Professor David Miles, who is now with the OBR, said that there was misplaced confidence that interest rates could not go to 3% or 3.5%. Is that fair or is that being too pessimistic?

Silvana Tenreyro: I do not know what horizon he was talking about.

Q369 **Kevin Hollinrake:** He was talking about dealing with inflation in the shorter term, rather than a longer-term demographic issue.

Ben Broadbent: Thankfully, I am not in the business where I have to forecast what interest rates are going to be in a year or two years. That may seem odd, because I am on the committee that does them, but our job is, at each point in time, to say, "What is the outlook for inflation?" and to set the current level of interest rates accordingly. That is the best approach, because our objective is not to make particular levels of interest rates more or less uncertain, but to control inflation in the medium term. I do not know what will prove necessary.

As Silvana was saying, we lived with very low interest rates without inflation. The implication is that that equilibrium rate had been falling, certainly since, say, the 90s. My own view is that the factors that drove that are unlikely to have turned around very dramatically, but that does not mean that I can tell you exactly what interest rates will be.

Q370 **Kevin Hollinrake:** I guess that all predictions about the future are difficult to make. Andrew, I can see you itching to come in. To put this into context, I know that this is more of a strategic line of questioning rather than the immediate issues that you are facing today. There is a dependency in the economy, from both consumers and businesses, who have become reliant on very low interest rates.

I know that lots of different people are making predictions about the future. Professor Charles Goodhart has talked about a "great demographic reversal" and China's ageing population driving inflation, effectively. Are we going to put ourselves in a vulnerable position when people have been used to those very low interest rates?

Andrew Bailey: I will link that with what I was just about to say. Silvana very rightly set out what I would call a very helpful framework for thinking about rates in the medium term and then in the somewhat shorter term, but it is only a framework. It does not tell us the answer, meeting to meeting.

Silvana mentioned that the longer-term drivers were demographics—population growth, longevity and productivity growth. Charles Goodhart takes a different view on those. I do not particularly agree with him on those points, and our former colleague, Jan Vlieghe, made a very good speech on that subject towards the middle of last year. Charles's different position is because he takes a quite different view on those long-run drivers of what Silvana described as trend R or R*.

Q371 **Kevin Hollinrake:** The other issue, of course, is that keeping interest rates very low limits your room for manoeuvre in terms of stimulus and monetary policy. We had a number of economists come to talk to us a week or two ago—Jim O'Neill, Roger Bootle and Professor Chadha—who all said that neutral interest rates should be between 2% and 3%. Is it possible that we can get back there to give you more capability to manage the economy more effectively?

Silvana Tenreyro: You do not create a recession to have more room later.

Q372 **Kevin Hollinrake:** Do you think that that is what would happen?

Silvana Tenreyro: If you hike rates just for that reason, you would tighten the economy to the point of driving it to recession, and then, of course, you would have some room to lower rates later to fight an even deeper recession. Meanwhile, you kept everyone in recession all these years. I do not see the logic of the ammunition, personally.

Q373 **Kevin Hollinrake:** You would see that the risks to consumers and businesses, which are significant, from potentially high interest rates, are potentially overblown by people saying that rates could go to those levels.

Silvana Tenreyro: Just for the ammunition reason on its own, it does not stand together. That is all I am saying. You said interest rates. As Ben was saying, in order to hit the inflation target and, subject to that, to minimise disruption to output and employment, that is our remit. Our remit does not tell us to build ammunition.

Q374 **Emma Hardy:** I am going to start on a slightly unusual point. Jonathan, you said something that really interested me, which means that I can return to one of my favourite subjects, which, of course, is Hull. It is about the productivity gap and remote working. Other than Martin Sandbu, who talked in the *FT* about remote working as a possible way of raising productivity in different regions of the UK, you are the only person I have heard mention it. I just wondered if you wanted to elaborate on that point a little bit.

Jonathan Haskel: We do not know the answer yet. We are not quite sure how this all shakes out. Going back to the investment numbers we have talked about, one thing that we have seen is a very substantial fall in investment in commercial buildings. That looks like, back to the earlier discussion, we may have a rather more long-run structural change towards more people working from home and all of that.

We think that that may increase the level of productivity from people working from home, but it depends on all the different tasks. It is quite a complicated picture and it is early to say. There may be a straw in the wind that that might be a potential way of raising productivity.

Q375 **Emma Hardy:** That is really interesting. When I was talking to Martin Sandbu about it, he expressed surprise that the Government's levelling-up White Paper made no reference to the idea that remote working could, in some way, address lower levels of productivity in some of the regions. Do you feel the same way?

Jonathan Haskel: I have not really thought it through in terms of the levelling-up issues. The difficulty, of course, is that we also think that one of the important determinants of productivity in regions is the cluster of activities in those different regions. Where that takes you is to the nature of jobs in different regions.

To talk about the productivity of a job is not very helpful, because a job is a bundle of tasks. If I have a task as a call-centre worker, with a relatively small number of tasks that I can do either at home or at the office, it probably does not make too much difference. If, on the other hand, my job consists of a bundle of tasks that mean interacting with colleagues and all that kind of thing, it may be much more geographically dependent, at which point the cluster of activities and the region where I am are going to be more important.

Q376 **Emma Hardy:** I will not get side-tracked on it now, but I would love to explore it in more detail and I would be grateful for any further thoughts you have on that issue.

Governor, I was enjoying you talking about the need for greater bargaining power for the lowest-paid, because it sounded like a wonderful advert to join a trade union. Well put there, Governor.

Andrew Bailey: You will get me into trouble again.

Q377 **Emma Hardy:** "And so say all of us" is what I can say on that. Greater bargaining power—let us do it. I just wondered if I might turn to the issues around the tightness in the labour market. I was reading this extract from the Institute for Employment Studies *Labour Market Statistics*; it really concerned me, and I am going to quote it now: "Worryingly, new data today on employment for disabled people also suggests that the employment 'gap' between disabled people and non-disabled people is widening, as unsurprisingly is the gap for people aged over 50. Those who were most disadvantaged in the labour market before the crisis, and particularly those with health conditions, appear to be faring worst in the recovery." I just wondered how concerned you are about the drop in labour market participation and inactivity levels, especially amongst older people.

Jonathan Haskel: Hats off to the Institute for Employment Studies. Tony Wilson there has done some fantastic work on all of this. My understanding of what he said is that we have a participation gap of about 500,000 people. Of that, around 230,000, if I remember correctly, are people who are short or long-term sick. In addition to that—sorry, I have the figures buried here and I am speaking from memory now, so forgive me—there is a participation gap in the over-50s. There is a multidimensional thing.

What is interesting and difficult to interpret about that from a policy point of view, which is not something that we should talk about, but simply from the data point of view, is that the reasons for that participation gap have changed a lot over the pandemic. In the early period of the pandemic, it was not so much sickness. It was much more students and people who were looking after dependants. Now, as we have got to the later period of the pandemic, it has become much more concentrated amongst older people and people with ill health.

Again, it is back to the earlier discussion. There is not much that monetary policy can do about that, but the reason that I just wanted to come in—forgive me—is that what makes it rather difficult for us to decode that and then set monetary policy is that the reasons for that have waxed and waned over the period.

Andrew Bailey: I would add two thoughts. First of all, in terms of this group that has come out of participating in the labour force, and particularly the older group, as it is more concentrated, it is, as Jonathan said, very hard for us to assess whether that group wants to come back into the labour market or has re-evaluated life and decided to retire earlier. We just do not know.

Silvana Tenreyro: It is a natural feature of downturns that labour force participation falls and then catches up over time. There might still be scope for some catching up. The possibility of elective working from home could be a good opportunity for people with disabilities, for example.

Andrew Bailey: That was going to be my second point. On Silvana's point, what we have seen, as Jonathan referred to, is that this coming back into the labour force has happened for those younger people who decided to spend longer in full-time education. That is a sensible and natural thing and, as Silvana says, that is something that we have seen before.

I was going to reiterate the point Silvana has just made. It is not a monetary policy point. We need, of course, to see as many people participate now as can, because the labour market is very tight, so I hope, to your point, that that creates a greater incentive for people to think seriously about how you can employ people with disabilities, because that is important for all sorts of reasons.

Q378 **Emma Hardy:** What are the repercussions, as older workers leave the labour market and with higher levels of economic inactivity, on the longer-term outlook? What impact will this have, if we continue seeing older workers leaving the labour market in the way we have?

Jonathan Haskel: In short, the labour market will be tighter than it would otherwise be.

Silvana Tenreyro: There will be some demand repercussions as well. Activity will shrink, compared to the counterfactual, and we will see lower activity. In terms of the impact on inflation, it is unclear. With lower incomes, demand will also fall. Where that balance will sit is the quantitative question.

Ben Broadbent: Silvana mentioned the cyclicality of participation. To be clear, it has recovered. For the last year, it has been rising, not falling. It is not back to where it was, so there is still a shortfall, which is the source of what you are saying.

Emma Hardy: I was referring particularly to older people.

Ben Broadbent: Forgive me, yes, and I was talking about the aggregate.

Andrew Bailey: It has become more concentrated in older people.

Ben Broadbent: The other point that I would make is that, over many years, we have had an ageing population. Even for a given date of retirement, as it were, the workforce would tend to shrink, because there are more people retiring than coming in. That has been the underlying trend for quite a long time, because we are an ageing population. Until the pandemic, that had been broadly offset by the opposite trend to the one you are talking about—people staying in the labour market for longer.

We do not know yet. There would be a change if that stopped happening. Even if you do not get a lot of earlier retirement, if you do not have this continual process of people staying in the labour market beyond the conventional retirement age, which is the trend we have seen for the last 20 years, we will start to see the labour force shrink on a more trend-like basis.

As Silvana said, we always think about what the implications are of X, Y or Z for inflation, but I do not think that there are direct ones in that sense. It is a real phenomenon. It would mean lower trend growth in the economy in aggregate. That would be the implication. You have seen that in other countries—certainly in Europe—where lower rates of workforce growth have been a contributor to lower rates of aggregate economic growth.

Q379 **Emma Hardy:** Therefore, do you think it is something serious enough for the Government to look at responding to? I am not asking you to say what action the Government should take, but is this trend towards people over the age of 50 leaving the labour market, becoming inactive and not returning something that Government should be responding to, because of the economic consequences you have just outlined?

Andrew Bailey: I do not think what we are far enough out of Covid yet to really know how this is going to settle down. Let us face it: we are still only just coming out of the latest wave. We need to see some more time before we know the answer to this question in the longer term.

Silvana Tenreyro: It will be important to understand why people are not coming back, if it is a personal decision versus some impediment that is making it difficult for them and could be lifted somehow. It requires more research into the causes.

Jonathan Haskel: The missing element is long Covid. We do not know whether long Covid is disproportionately affecting, as Silvana was just mentioning, those people who might be withdrawing from the labour market, because we have not matched up the data with the labour market status and the long Covid status. I believe those studies are underway.

Andrew Bailey: The other thing to say as well is that we have had, as we have said at previous hearings, I think, quite a large build-up in unanticipated saving in the economy. We think that it is not evenly distributed, although we do not know a lot about that. It is possible that some people, for a period of time, will treat that as a source of income and then will return to the labour market. We do not know.

Q380 **Emma Hardy:** It is interesting, going back to the Institute for Employment Studies, that it mentions people leaving due to ill health or retirement, as well as people leaving at the end of the coronavirus job retention scheme. There seem to be big question marks.

Andrew Bailey: There are a lot of question marks in there, yes.

Jonathan Haskel: What is interesting about that is the trend of people reporting ill health is pretty much unchanged since even before Covid. That has been on a trend increase before Covid. You would think, "With all these people not working, it must be long Covid", but the trend of people reporting ill health has been on an upward trend for 20-odd years. In that Institute for Employment Studies document, it documents that that is more or less the same, actually.

Q381 **Emma Hardy:** Jonathan, in a recent speech, you said that the Bank rate will have to rise if the labour market stays tight. Can you elaborate on that?

Jonathan Haskel: It goes on to what we were saying earlier on and what I talked about in my report to the Committee. Ben also talked about this much more crisply than me. If you go back to October or November, which is when I was making this speech, we had some sense of wage pressure building a little bit, but unemployment—normally a pretty reliable indicator of the amount of pressure on wages—had risen only a small amount over the course of the pandemic, but we had, as we mentioned earlier on, a million workers on furlough. The week before the furlough scheme ended, a million workers were on furlough; that is an absolutely enormous number of workers.

We did not know then quite how tight or loose the labour market was going to be. Maybe it was going to be very difficult for those million workers once the pandemic was over, if nobody wanted to go to restaurants and nightclubs any more. In that case, for us to have raised rates would have been a horrible thing to do, because there would have been a lot of slack in the labour market. As it turned out, that worked out to be much better than that outcome. In that speech, I was trying to say that it was very difficult to detect what labour market pressure was last year. As it now turns out, we think the labour market is quite tight and therefore the policy implications from that follow.

Q382 **Emma Hardy:** You said that the labour market is quite tight. How significant is that as a problem? How tight do you think it is?

Jonathan Haskel: It is not a problem. Having a tight labour market is a good thing, in the sense of the good opportunities for people around. To give you some sense of it, the ratio I rather like is the vacancy to unemployment ratio.

Emma Hardy: It is one-to-one.

Jonathan Haskel: Yes, exactly. Before we went into the pandemic, there were roughly two unemployed workers chasing every vacancy. Now there is roughly one unemployed worker chasing one vacancy, if you see what I mean, so there is much less competition for vacancies. That is obviously good for job opportunities.

Q383 **Emma Hardy:** If they are regionally available and not all located in certain geographical areas, which goes back to the point about remote working.

Jonathan Haskel: Yes, indeed. We looked at that extensively last year. I am not sure whether it was updated when we looked at the various mismatch indices. I cannot remember whether we looked at those on a regional or industrial basis.

Ben Broadbent: We had some evidence on regional but much less, because it is hard to split the vacancies numbers regionally. Regionally, certainly through the course of the pandemic and the course of last year, we have seen that—with the big caveat that we do not have a lot of information—it appeared tighter outside the big cities. That is not necessarily a great swathe in one direction in the country or another, but certainly conditions in London in particular look less tight, for example, than those outside. I will stop there.

Q384 **Emma Hardy:** I need to move on to the next bit, but it would be interesting to look at that regional disparity in the types of jobs and therefore the impact in the different areas.

Jonathan Haskel: We looked in quite a lot of detail at the industry numbers and asked the question, "How many vacancies are there in industry X and how many unemployed people are ready to work in industry X?" Interestingly, that mismatch index had shown a sharp increase, but then it fell right back down again, suggesting that there was not much mismatch, at least in that dimension. To the extent that industries are correlated with regions, that gives you a little bit of an insight into regions, but there is not a 100% read-across to regions; that is true.

Q385 **Emma Hardy:** I wanted to talk a bit about the cost of living. I am going to give you a really easy question, Governor, and I hope you are going to say nice things. I was quite interested when you were talking to my friend Angela and I have written down that you said that companies should think about their profit margin and their costs. As a nice opener, I wondered if you will share my congratulations to Jack Monroe, the food poverty campaigner, who managed to get Asda not only to think about its costs but actually reduce many of its costs for its basic goods, which had been increased so dramatically. There is a nice question for you, Governor.

Andrew Bailey: That shows that the market is working, but it had to be brought to public attention, which is why these things have to be said. It is a matter of bringing them to attention.

Q386 **Emma Hardy:** Now they have been brought to attention, you are pleased that the supermarket has acted in that way. Would you like to see similar supermarkets acting in a way of restraining some of their profits or prices?

Andrew Bailey: It is not for us to dictate to people what they do. The fact that there is evidence of a market working in that sense, admittedly once the issue was brought to the public's attention, is helpful. It is a pricing mechanism working.

Jonathan Haskel: Could I come in? Forgive me; I wear another hat because I am on the board of the UK Statistics Authority. This raises an issue about how we measure inflation. Hats off to Jack Monroe for bringing this to people's attention. It is about whether the inflation measure—we are targeting average inflation—is salient to lots of individuals. People from the ONS have met with Jack Monroe, as you will know.

Before the pandemic—I will say "we", with my ONS hat on—we used to publish different inflation indices for people, pensioners and different people in the income distribution. That was suspended over the course of the pandemic because the ONS had a couple of other things to do, like running the infection survey and all that kind of thing. That is going to be restored and the ONS is working hard and has a whole programme, as I say, and has met with Jack Monroe to examine the extent to which these price indices can be split out in various different ways.

I will say one more thing, if I may, because it gets me very excited. There are these difficult conceptual issues about how you construct price indices in the circumstances that Jack Monroe describes. When she describes that they go to a supermarket, cannot find a basic good any more and have to switch from a basic pasta to a more expensive pasta, in the price index world we do not treat that as a rise in prices. We think that basic pasta and fancy pasta is at least some change in quality. When the person is doing that switch, what is salient to them is that it is an increase in prices, but they are switching their consumption basket, as opposed to raising the price of the basic pasta.

There are some quite tricky conceptual issues about putting these inflation indices together. It is one of the reasons why there may be a mismatch between the kinds of inflation that perhaps your constituents perceive and the kinds of inflation that are measured officially.

Q387 **Emma Hardy:** That is really interesting. Her campaign highlighted that, for those relying on the more basic goods, they were seeing 70%-plus increases in their costs, compared to those consumers who were not relying on basic goods and would have always bought more expensive items. If there is a different way to measure that and illustrate that, which does not mean that we have our one food poverty campaigner having to go out there on every national media channel and advertise it, that would be great to have that information and make that point that she has made.

I want to ask now particularly about younger people and the cost of living. Do you think that the cost of living increases have had a disproportionate impact on younger people, or do you see it more as older people who are going to be the worst affected because of, for example, the hike in gas prices?

Andrew Bailey: You have a bit more ONS evidence, have you not?

Jonathan Haskel: The ONS has put out a release on this. It did two comparisons. I think the comparison was between retirees and—I cannot quite remember. It was older and younger people.

Silvana Tenreyro: It was retired and non-retired.

Jonathan Haskel: Thank you, Silvana; retired and non-retired, and between high income and low income. From memory, that release showed roughly the same price inflation challenges facing both of those groups. The reason for high-income and low-income people is that low-income people spend more on gas, household goods and all that. High-income people spend more on restaurant meals, hotels and all that kind of thing.

Silvana Tenreyro: Transport costs.

Jonathan Haskel: Transport, yes, thanks. Those prices have gone up, and the gas price, as we were just discussing in a lot of detail, has gone up as well. In fact, the rate of inflation for those two different groups is rather similar.

Q388 **Emma Hardy:** I am going to draw a quote from this *Financial Times* article, "Britain's young face a poorer future". In this article, it says, "The Government is freezing the income level at which graduates will be asked to start paying back their student loans. Inflation will therefore draw many, not very well-paid, graduates into repayment—equivalent to an increase in income tax of around 9% a year. A combination of such 'stealth taxes' and the increase in national insurance mean that the Intergenerational Foundation, a think-tank, estimates the disposable income of a typical 27-year-old graduate will fall by close to 30% over four years as a cost of living crisis looms". Is that something you recognise or would agree with?

Andrew Bailey: We take announced Government policy in, as it were. We do not second-guess it. Where we can, we also use the OBR's conventions and interpretations of the impact of those policies so that, again, wherever we can, we do not second-guess that.

Q389 **Emma Hardy:** I am going to ask you to do a bit of guessing and a bit of predicting. If this is correct and for some young people it will be the first time dealing with significant price rises, what you do think that will mean for how they react? Do you predict that they will consume less, save more or less, work harder, bargain for wages, change jobs or a mixture of all of these? What would that mean for the economy?

Andrew Bailey: I suspect, going back to what I was saying earlier, it will be a mixture. It depends on their bargaining power, for instance in the labour market.

Emma Hardy: You are going back to joining a trade union there, Governor, are you not?

Silvana Tenreyro: It is a real income shock for them and so there will be a wealth effect, which will potentially drive them to work more. In that sense, you probably would expect them to participate more. On the other hand, there is a substitution effect, as we call it in economics. It is less attractive to work because you are making less. In this instance, because of the cost of living hit, the wealth effect is likely to dominate and will then mean that they will be more eager to work, in terms of that margin at least.

In terms of consumption, it is a big hit to real incomes, so they would probably need to cut consumption on other items in the basket.

Andrew Bailey: That is an aggregate.

Silvana Tenreyro: Yes, but also for individual people who are hit by the shock.

Q390 **Chair:** Can I go quickly back to employment? We talked about unemployment, the employment levels, people dropping out and becoming economically inactive. The Government say—I assume this is correct—that the level of payroll employment is higher now than it was before the pandemic. How do you square that with what is going on? Does that lead you into, I think, concluding that the level of self-employment has climbed quite markedly?

Andrew Bailey: It has, yes.

Q391 **Chair:** What are your observations of that? What do you think has driven that? Has that been driven by a flight to greater certainty of working for somebody else in difficult times? Has some of it been to do with the way IR35 has impacted on that group?

Andrew Bailey: IR35 is a factor.

Q392 **Chair:** Therefore more of them are basically changing the way they operate. Is that what has happened?

Andrew Bailey: I in no sense claim to be an expert on IR35, but my understanding is that it has that effect. In some circumstances, it means that somebody who was being treated as self-employed previously actually cannot be treated as self-employed. That is particularly when you are contracting over longer terms to the same employer. It has contributed. I honestly do not know what contribution it has made.

Ben Broadbent: Also, remember that a disproportionate part of that growth in overall employment has come from the public sector, where people are much more universally employees, rather than self-employed. Necessarily that will have had some impact. Private sector employment in aggregate, whether in payroll or self-employed, is still lower than it was before the pandemic.

Q393 **Siobhain McDonagh:** Governor, I get the impression this morning that you are feeling slightly sensitive about the reaction to your comments about pay restraint. I wonder if you can understand people's responses, in that we have often spoken at this Committee about the different impacts that the pandemic has had on different groups of people. Wealthier people generally got wealthier, were able to work from home, make substantial savings, while frontline workers, particularly carers, of course could not do that. They were putting themselves in harm's way, were doing their job, were not able to save and were experiencing very low pay, in a market that clearly does not work. These people are very much in demand. They also have essential skills that we may all, however mighty, at some point in our lives actually need.

Do you think there might be a specific reason why we should see carers looked at for increased earnings? I know we have spoken a lot about trade union membership this morning, which is quite unusual for the Treasury Select Committee, but the GMB is calling for £15 an hour pay for people who are carers. Would you agree with that?

Andrew Bailey: Can I put it into context? I have, hopefully, added something to the comments this morning, which I wanted to, because it was a particular question I was asked. As I said, I am very concerned about the second-round effects. There are the effects we can see for inflation. Also, as I said, it is coming back to this point about the fact that those effects will not be evenly distributed. There are groups in society that will be much more severely affected.

I do not think it is appropriate for me, as Governor of the Bank of England, to make an observation about the pay level of a particular group in society. I will take my Governor's hat off. My mother was in a care home for several years. I have had close experience of it. I have an enormous respect for people who work in care homes. It is a very difficult environment to work in. I will put my Governor hat back on now. It is a private observation that I will make to you.

Q394 **Siobhain McDonagh:** Thank you. You can understand how emotional people feel, particularly about this group of people.

Andrew Bailey: I completely understand the point. The comment I made applies to the economy as a whole. I know that it is unpopular to say it, but there is a real risk here. It is something that we have to have in mind. That is an aggregate comment about second-round effects.

Q395 **Siobhain McDonagh:** We understand your point, Governor. My mum, who was a nurse, always had a political phrase, which was, "Much gets more". Today, we have heard on the radio and in the newspapers that bankers' bonuses are back with a bang. Barclays, which could not afford to keep its branch open in Mitcham town centre, and HSBC, which started charging business rates to voluntary groups, will be raising their bonus pots by a staggering 23% and 31% respectively. There seems to be a disconnect between those who are really struggling and those who are not struggling even before they get their bonuses. Would you like to make a statement about the impact on inflation of these sorts of bankers' bonuses?

Andrew Bailey: Unfortunately, it illustrates the point I was making. In a process where there are people essentially trying to offset the shock to real income that we have had from outside, some will be better able to do it than others. I am not making a particular point about bankers at that point. By the way, I should say, wearing another of my hats, the bonus cap is still in place, but that obviously gives scope within it. I am not saying that that stops bonuses increasing, but it caps them.

It illustrates my point, as a broader matter, that the impact of this will fall unequally. It is not my role as Governor of the Bank of England to dictate the outcomes, but I am going to use my position to say that we need to be very clear that those things can follow. There are very big limits to what I can do about it, but I want to point that out. That is one of the reasons I made the comments. I know I am pretty unpopular for it, but I really want to emphasise that point.

Q396 **Siobhain McDonagh:** Do you see the need for even-handedness? We have had a generalised statement about people's earnings and now we have a substantial return to bankers' bonuses. Do you have something to say to the banking world about the bonuses?

Andrew Bailey: I am not going to treat this as a particular bankers' point. It is a point about the labour market as a whole. The Bank of England cannot dictate the outcomes there. I felt that I had a responsibility, from the point of view of the economics of this and the second-round effects, to point it out, unpopular though it is.

Q397 **Siobhain McDonagh:** There seem to be quite a few things going on in the banking world—closing branches and reducing services to customers. One thing that really shocked me recently was about a number of voluntary groups that require membership and often provide a lifeline to people. We are all hearing about more people with mental health problems, who are worried about increasing prices and how they are going to meet them, requiring many of these groups' help. HSBC is now deciding to extend all the business charges to these groups. Do you agree that it should reconsider such a policy?

Andrew Bailey: Wearing my former hat, that is an issue that you should take up with the FCA. Access to banking is an important issue. It is an FCA issue.

Q398 **Siobhain McDonagh:** We have had lots of discussions about how the pandemic has affected higher and lower-income families. Given this, do you think that the gap between lower-income households and higher-income households has widened or closed during the pandemic? What impact have the Bank of England's decisions during the pandemic had on that gap?

Andrew Bailey: I am afraid to say that I do not think I have seen particular data on that. I would observe, as we have said in the past, that certainly in the early phases of the pandemic, the impact was probably larger on the less well paid. The reason is that Covid had a bigger impact on those parts of the service sector that require close human contact. We know that there is a larger concentration of low-paid workers in those sectors, so it did. To be honest with you, I have not seen any evidence—I do not know whether any of my colleagues have—out of Covid as to where that has got to.

Ben Broadbent: We have not yet had the survey data that tell us about income inequality. They come out with quite a delay, so we are not in a position to say. I will say that those things have been pretty flat, actually, both for income and for wealth, over the last, broadly speaking, 20 or 25 years. They really have not done much. The UK stands in some contrast to, say, the US and indeed some countries in Europe, where those measures of inequality have been rising.

Beyond what Andrew has said, we do not know about the likely effect of the pandemic, because of the skew in the job losses to the very sectors you were talking about—those that require human contact. We have not had the official data that tell us the consequences for income inequality.

Q399 **Siobhain McDonagh:** If we look at housing, there seems to me to be a huge gap in the difference between poor and wealthy people's ability to own their own home. Given the extraordinary increase in house prices, both during and since the pandemic, with the dream of home ownership being further away for even more people, do you think in retrospect that the Government's introduction of the stamp duty holiday was a wise move, or did it just stoke property prices further?

Andrew Bailey: I am not going to comment on Government policy, if you do not mind. This is an FPC point, actually. I think I am right in saying that the proportion of first-time buyers among total buyers has actually increased in recent years. We have recently reviewed the FPC's housing tools.

Q400 **Siobhain McDonagh:** It is not back to 1990s levels or early 2000s levels.

Andrew Bailey: I would really have to come back to you on that. I do not know off the top of my head. We recently reviewed the FPC's housing tools and that caused us to look at the housing market. Because we have got a point on first-time buyers in the FPC remit letter, we did look at this. Our strong conclusion is that the biggest thing limiting people coming into the housing market is affording the deposit.

Q401 **Anthony Browne:** I am not going to ask you about monetary policy to start with. I am going to ask about something more topical. Yesterday, the Government imposed sanctions on five Russian banks. Do you think that will have any impact on London as a financial centre?

Andrew Bailey: These sanctions are very important. I am not going to comment on the tactics and strategy of diplomacy in terms of sanctions.

Q402 **Anthony Browne:** I am not asking you to comment on sanctions policy; it is just the impact of the sanctions.

Andrew Bailey: I want to endorse what the Prime Minister has said, which is that it is absolutely important that these sanctions are applied with rigour. There is a lot of talk about scaling up sanctions. That is not for us to judge. That is tactics of diplomacy.

Q403 **Anthony Browne:** No, I agree. I would not expect you to comment on sanctions policy. It is about the impact of the sanctions.

Andrew Bailey: It is clear that they have to be applied with rigour. That is the thing.

Q404 **Anthony Browne:** What is needed to apply them with rigour?

Andrew Bailey: Everybody involved has to get on with it, frankly, and do it rigorously.

Q405 **Anthony Browne:** There is a view out there among certain commentators that London is so awash with Russian money that we risk self-harm by sanctioning Russian banks more severely. Do you think that there is a risk to London as a financial centre if we, for example, stopped all Russian banks having access to clearing banks and therefore access to the Bank of England?

Andrew Bailey: It is for the Government to lead on that, and they are leading on it. Where we have been asked, the Bank of England has provided technical advice on various things through the Ukrainian crisis. They can have as much of our advice and support as is needed, because we are strong supporters. The only thing I will say is that this situation is so serious that, as the Prime Minister has said, we must put it first. I do not think that saying, "This could be a bit damaging to London as a financial centre", is an argument that holds water.

Q406 **Anthony Browne:** I certainly personally fully agree with that. There has been speculation that America will push for Russia not to have access to the SWIFT global payment system. What do you think the impact of that will be?

Andrew Bailey: In many ways, I would suspect that it would be quite substantial. There is talk about the fact that alternatives have been developed by other countries. I am not in a position to judge how real those alternatives are, because I do not think they have been used extensively yet.

Q407 **Anthony Browne:** Coming back to the point about Russian banks, Sberbank is listed on the London Stock Exchange; it has a capitalisation of £43 billion and is one of the biggest market capitalisation banks in the UK. What impact would stopping them having access to clearing banks, and to the Bank of England as a result, have on their operations?

Andrew Bailey: It could cause substantial impact, I suspect. When you say access to the Bank of England, they do not borrow from us.

Q408 **Anthony Browne:** I know they do not. I know they are not clearing banks, but they do obviously operate through UK clearing banks.

Andrew Bailey: They are in the market, yes. Obviously, rigorously applied sanctions would have a substantial impact.

Q409 **Kevin Hollinrake:** On a similar theme, you might have seen the debate in the Chamber yesterday about sanctions being applied. I am not asking you to comment at all on Government policy. As Anthony was saying, it is about what the systemic risk is if we do that. If we, effectively, cut Russia off completely from the City of London and other financial markets, what impact would there be on our banks? We talked about Sberbank, for example. There has been no sanction on that yet, but it is a huge bank and there is interdependency, clearly, with other banking sectors.

Andrew Bailey: I can tell you, because obviously we do look at this from the point of view of both the PRC and the FPC, that the UK banking system's exposure to Russia is very low. We start from a position where those exposures are low.

Q410 **Kevin Hollinrake:** You do not see a systemic risk if we did that in terms of the UK financial sector.

Andrew Bailey: I do not see a systemic risk to the UK banking system, no. We will obviously watch it, as you can imagine, and are watching it very carefully. We are working very closely with the Government on it and will continue to do so.

Q411 **Kevin Hollinrake:** Is it possible that we could cut Russian banks off from our clearing banks? Again, would that mean any systemic issue for the UK financial sector?

Andrew Bailey: No, for the UK financial sector it is not a systemic issue, no.

Q412 **Kevin Hollinrake:** Could you comment on how damaging that might be for another country like Russia if we did that?

Andrew Bailey: That is very hard for me. I cannot comment on that because I do not know enough about how the Russian financial system works today and would work tomorrow in the event of that happening. I just cannot comment. I just want to comment that we are very strong supporters of what the Government want to do. We will give all the help that is needed to do what the Government want to do on this.

Kevin Hollinrake: That is good to hear, thank you.

Q413 **Anthony Browne:** I did have some other questions on monetary policy, sticking with the global theme but from a monetary point of view. In your Monetary Policy Committee reports, you have stressed the importance of global inflationary pressures. In the UK debate, we tend to focus on inflation in the UK, but actually it is just as high or higher in America, Germany and elsewhere. How serious is the impact of global inflationary pressures on the UK? Does it not mean that the interest rate changes you make here will have limited impact, if it is all driven by global pressure?

Ben Broadbent: To take the second point first, I do not think that is the case. There are many influences on inflation that are domestic that we cannot directly do something about, but the ultimate influence on inflation over the medium term is monetary policy, regardless of what shocks there are in the short term or where they arise. The global point is very significant. In fact, we have been pointing it out for a lot longer than just February. It has been evident throughout the last year.

We have talked, for example, about the big switch in spending away from services to goods that occurred everywhere during the pandemic and has gone on. It has persisted for much longer, certainly, than I expected when it first became apparent in this country, which was over a year ago. We have been talking about the supply chain problems, and then this morning separately about energy. These things have been going on for quite a long time. The vast bulk of the overshoot in inflation in this country relative to target is due to these factors. We began the session by talking about whether the shocks to inflation would be transitory or permanent, and that is the biggest single component.

My own view is that those contributions will be transitory. That is why we have instead been focused a lot, over the last six months or so, on the domestic stuff, the risks of second-round effects that Andrew was talking about and the tightness of the labour market. Despite the fact that these contributions to inflation currently are very significant and overwhelmingly global, looking ahead two or three years, as we should, our focus has been more on the domestic costs and domestic cost inflation.

That is why the considerations that Jonathan was talking about—the furlough scheme, the tightness of the labour market and so forth, and all of the stuff we were thinking about in the summer—have been the more important things for policy decisions. We cannot do nothing about it, but it is because, ultimately, our judgment is that these impulses, enormous though they are at the moment, on inflation from the global forces will not endure, and because the domestic cost tends to be the more persistent source of inflation. That is why our focus has been on the domestic stuff.

Q414 **Anthony Browne:** Is it not still the case that, while global inflation continues at such a high rate and is exported to the UK, it is going to be difficult to get inflation in the UK under control?

Ben Broadbent: That is true. It is true that it is a huge source of risk to headline inflation, but think about, for example, the contribution of gas prices. It is enormous, as we have discussed—the biggest increase in energy prices in a year relative to household income ever, probably.

Even if gas prices stay at a very high level, which is not the central expectation in markets, as we have discussed, the direct contribution to inflation will come down. You have to imagine that they will carry on increasing at whatever we have seen—a four-fold increase—all the time for that not to happen. Just a stabilisation at a very high level would mean a very steep fall in their contribution to inflation. Even in our central forecast where we assume that happens—that they stay at this very high level indefinitely—inflation does come down. It remains above the target in a couple of years, but nothing like the current rates.

You are right, that, were it to carry on, were we to have another four-fold increase in the price of gas, yes, but certainly in the eyes of the marketplace that is pretty unlikely. Indeed, the market price then falls in level. In other words, if you look at the scenario based on the full market profile of gas, inflation in two or three years is comfortably below target. The outlook is hugely sensitive to these developments, but when you say, "If it carries on", I am just saying that, wherever you see financial markets pricing future events, that is a long way from what is expected.

Q415 **Anthony Browne:** Given all that, what do you see as the main international risk to the UK, or to the UK economy, in terms of growth and inflation?

Ben Broadbent: That is clearly the main source of risk at the moment, in terms of global prices of energy and other globally traded goods. Beyond that, I would not venture to say what the main risks are. There are all sorts of geopolitical events that have other effects.

Q416 **Anthony Browne:** That was the last question. Clearly, with events in Russia and Ukraine, there is concern about gas prices spiking even further as a result.

Ben Broadbent: Yes. Ms Ali asked us earlier if we should change the way we do the forecast; I do not think we should. The way we do the forecast means that the best approach we can take, which is what we do, is to base our projections on prices in financial markets, forward energy markets and so forth, on the view that those represent a pretty reasonable best stab at the future. There is still enormous uncertainty but we then take our policy decisions accordingly. Those global energy markets are also looking at developments in Ukraine, obviously, and trying to price as best they can the risk to future gas prices. We cannot do better than just take those prices as given.

Q417 **Anthony Browne:** That could spill over to renewed inflation in the UK.

Ben Broadbent: We began the session talking about that sort of thing. As it happens, the spot price—the price of buying gas right now—is not much different, despite all of these developments, than we had in the February inflation report. We will continue to base the forecast on those things, however they develop.

Chair: That brings us to the end. Thank you all very much for coming to see us today. It has been helpful, informative and instructive, as it always is. It was quite wide-ranging. We have covered the usual suspects, but we have also touched on sanctions. We will ponder whether you, Governor, will be joining a trade union.

Andrew Bailey: I am not sure one will let me in, actually.

Emma Hardy: I am sure, for the subs they could charge you, they would definitely let you in.

Chair: Jonathan, you opined on different qualities of pasta, but there was no recommendation, so perhaps you could write to the Committee with your thoughts on that.

With inflation, I have this image of this unpredictable, jumpy horse that you are trying to tame, but you are doing it in a force 10 gale, which is coming from elsewhere. If you have any clever ideas as to how to control energy prices, that would be very helpful. In the absence of that, which is unlikely, let us just hope that they come down in due course. That concludes this session. Thank you very much.