

Answers to questions for Martin Taylor from House of Commons Treasury Committee

Personal/General

1. Do you have any business or financial connections or other commitments which might give rise to a conflict of interest in carrying out your duties as a member of the FPC?

None.

2. Why have you decided to stay on for a further term? What have you learned from your experience of being on the FPC so far? Do you plan to approach your work differently during your further term?

Two years is really not long enough, given that it takes a while in any organisation to learn the ropes (and the FPC, as a new committee, has been learning the ropes itself, so to speak). I find the work interesting and believe it to be worthwhile.

As to what I have learned: I think this comes under three headings. First, I've clearly learned a lot more about the detail of the matters with which the FPC is dealing. I've learned more about a subject that has interested me on and off for forty years – the nature of central bank decision-making and the constraints around it.

I have no present intention of approaching the work differently, but I hope to get better at it with practice.

3. Do you intend to serve for the full term for which you have been appointed?

I currently intend to serve the full term.

4. In what areas in particular do you hope to focus your work on the FPC in the next period of tenure? What is your main priority for research in your further term?

In the nature of the FPC it is difficult to answer this question, because we deal with unlikely events, the existence and probability of which change shape unpredictably. The Committee has to be alert to, and ready to respond to evolving realities.

I would expect us to devote more time to non-banks over the next couple of years, both as a source of healthy finance and as a source of risk. That said, banks, though far better capitalised than a few years ago, still combine leverage, maturity mismatch and credit risk while offering deposit guarantees, a cocktail of potential risk that will need constant attention.

I expect us to refine our thinking on the use of the countercyclical capital buffer, especially if economic recovery gathers pace. I am sure we shall do further work to deepen our understanding of the housing market, including the important buy-to-let segment. We are likely to spend more time on the overall approach to policymaking – how the instruments at our disposal interact, how we should choose between them, when powers of direction should be used rather than recommendation.

Financial stability and the Financial Policy Committee

5. What do you regard as the main challenges facing the FPC over your next period as an FPC member?

When I was appointed to the Committee I felt that the crucial challenge facing the FPC was the development of a reaction function, so that economic agents could begin to anticipate our response to events. Absent this, I thought there was a risk that macroprudential policy-making might be so enigmatic as to be itself, perversely, a source of potential instability. I believe that, in the last twelve months particularly, the Committee has come a long way in establishing a way of doing things which is increasingly understood by interested parties. As it develops, such understanding can come to make a policy intervention unnecessary by discouraging the behaviour that might have provoked it. I regard it as very important that we continue along this road.

This doesn't mean, in my view, that the Committee should never behave in an unexpected way. But the unexpected should be exceptional.

6. What do you think is currently the most significant risk to financial stability facing the UK?

I take Committee responsibility for the risks described in the latest *Financial Stability Report*, and do not differ from the judgements it lays out. The Committee deals with tail risks – by definition, low-probability events that would have a high impact if they were to materialise. Since these events are all – supposedly - individually unlikely, predicting what will happen is little more than a guessing game.

But what can be usefully noted is that the number of geo-political tail risks feels unusually large at the moment, and some of the tails are fatter than one would like. The question then is what the FPC can do about this. Mostly, we can try to ensure that the system is robust enough to stand up to any likely shock. A historic case in point was the recommendation by the interim FPC that banks should mitigate balance-sheet risks arising from stress in the Eurozone.

Stress-testing, too, specifically takes some tail risks into account and is useful as an additional check on the resilience of the core banking system.

7. What have been the successes of the statutory FPC, and where is there still work to be done?

As I suggested in answering question 5, I believe the main achievement has been the establishment of a distinctive footprint by the Committee. The intervention on housing was clearly an important moment in the year, as was our work on the leverage ratio and the FPC's contribution to the stress test carried out by the PRA. The Committee has established medium-term priorities, including work on the medium-term capital framework for banks and ending too-big-to-fail and the whole area of market-based finance.

8. Has the FPC operated free of all political interference?

I am unaware of any overt political interference in the workings of the Committee. The FPC, like the Bank of England as a whole, takes its independence very seriously. That said, of course we do not operate in a monastic environment, and our second objective requires us to support the economic policy objectives of the government of the day. Co-operation with HM Treasury is necessary in the interests of good policy-making. The FPC's reputation for independence, which needs to be vigilantly but not hysterically guarded, is the best guarantee that its independence will be respected now and going forward.

9. Have you received the support from the Bank that you need to fulfill your role? Are there any changes that the Bank could make to support external members of the FPC better?

It seems to me that the Bank offers us every facility and support. I am confident that any reasonable request for further help would be satisfied. I can't think of a systematic way of identifying tail risks that the organisation has missed: pretty much everyone else would have had to miss them too, since information flows quite freely around the world. The unexpected tends not to sit in plain view.

10. How well do you think the public understands the work of the FPC, and how important do you think it is that they do? How have you worked to increase the public profile of the FPC?

I think it's extremely important that the financial markets and major decision-makers understand the work of the FPC, and I believe that, increasingly, they do. The wider public needs to be aware of the broad issues rather than the detail: it would be a strange society in which the countercyclical capital buffer formed material for breakfast-time conversation. To be more concrete - it seems to me highly desirable that people should understand that the

Bank of England is working to make the financial system safer, and it certainly mattered last summer that people knew that the Bank was concerned about a possibly excessive build-up of housing debt. The message got out that housing was not a one-way bet: the fact that the FPC was the operative part of the Bank in this instance seems to me, from the public point of view, merely a detail.

I have done a fair amount of work over the last two years with the media and with the City;

I've made regional visits (I shall be in the East Midlands later this month) on which it is customary to meet local business audiences. I've made two public speeches, one rather more technical than the other.

There's an important difference between the public pronouncements of MPC and FPC members. The MPC votes, on interest rates and – currently – on QE. It is important that the outside world is informed in an orderly way of currents of feeling on the Committee; members who disagree with the majority are expected to say why. The FPC is required to work, where possible, by consensus, which argues against the ventilation of personal views.

11. How do you think the FPC is regarded by financial firms? How well do you think the FPC communicates with, and understands the concerns of, financial firms?

I'm supposing this question to refer to the managements of financial firms supervised by the PRA, rather than to financial analysts looking for the elucidation of policy. I believe they see us as a supervisor at one remove: that is, as a body empowered to make recommendations to the PRA on how it ought to regulate them. They will therefore have two broad sets of questions: 1) do they understand how the FPC reaches its decisions? 2) does it make intelligent decisions on the whole?

As I wrote in answering question 5, I do believe the surprise factor has been limited, partly because both the Governor and Jon Cunliffe, the relevant Deputy Governor, have outlined policy choices (acting on behalf of the Committee as a whole) in speeches well ahead of decision points. On the second point, it's my observation that the level of complaints by financial firms about policy has been a touch more muted in the last few months. That of course is no guarantee that we've been getting it right.

On the point of communicating - as opposed to consulting - with financial firms individually, we tend to leave this to the PRA. We are after all supposed to think of the system as a whole, rather than its components, and we should absolutely not get in the PRA's way.

12. How well are the FPC's financial stability indicators integrated in the work of the FPC, and how you personally think about financial stability?

We see the FPC core indicators all the time, of course, and we look very carefully at market information. The immense suite of analysis available to the MPC is also at our disposal. The indicators are a fundamental input to decision-making, but I see little value in a mechanistic approach; they need to be combined with judgement. I think it's important not to obsess about every market tremor – one can draw a caricature of a central bank staffer for whom every rising market is a bubble, every falling market a slump, while every steady market demonstrates an unnatural lack of volatility. Sorting out what is significant from what is really interesting requires the kind of skill and judgement that all of us feel we possess to some extent but nobody properly masters. Being an FPC member is one of those jobs, more common nowadays than before, where one is charged with worrying. I find this comes quite naturally – it's worrying intelligently that's hard.

13. How well do you think the power of recommendation has worked so far?

I feel the power of recommendation has worked well so far. Buttressing this power with powers of direction is clearly helpful; the extent to which it is necessary is for Parliament to judge. The FPC expects its recommendations to be complied with: so far they have been.

14. Do you agree with the conclusions and recommendations of the Warsh review as they concern the FPC?

The Warsh review seems very sensible to me. I am of course happy to discuss any specific points that interest or concern Treasury Committee members at the hearing.

15. How easy has it been to maintain consensus on the FPC? How far have you had to compromise to achieve consensus? Has there been any decision on which you personally have come close to breaking the consensus?

This is a hugely important set of questions. To take the last first, I have not come close to breaking consensus, if by that is meant requesting that disagreement should be recorded for public consumption. This implies that the compromises I have been required to make between my own view and the Committee consensus have been, if not entirely trivial, at least well short of important (and that answers the second question).

This in turn suggests either that the issues we've been confronted with have not been especially contentious, or that great care has been taken in the consensus-seeking process. I incline to the latter view, since we've clearly handled plenty of controversial stuff. The Committee meets frequently in the build-up of a round, and there is plenty of chance to air concerns long before they get baked into draft policy. I have been impressed by the understanding of the Governors, which has developed over the period of the statutory FPC's

existence, that consensus is built rather than merely arrived at. This is a very deliberate and conscious process.

That said, at some stage someone will feel uncomfortable enough to break ranks. That will be an important moment for the Committee, but need not be a threatening one. It will be the result of profound disagreement rather than careless process – or so I hope.