Questions from Treasury Committee on the reappointment of Andy Haldane to Monetary Policy Committee

A. Personal /general questions

1. *Do you intend to serve out the full term for which you have been re-appointed?*

Yes. It has been a privilege to serve two terms on the MPC and I look forward to serving a full third term at a challenging time.

2. *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 both Chief Economist of the Bank of England and a member of the MPC?*

The Treasury Committee will be aware that I have been Chair of the Government's Industrial Strategy Council (ISC) since late-2018. This is a non-remunerated role which I fulfil in an independent capacity on a part-time basis.

The ISC is tasked with evaluating the impact of the Government's Industrial Strategy, rather than providing policy advice. Industrial strategy focusses on improving the long-run supply capacity of the economy, which is beyond the horizon of monetary policy. So there is no conflict of interest between the two roles.

Issues of productivity are clearly of importance and interest to the MPC, as well as the ISC. In that sense, I believe my dual roles allow me better to fulfil my responsibilities to each body.

3. *What have you learnt over your term as Chief Economist, and what do you regard as your key achievements to date?*

The key role of any MPC member is to understand the economy and to set monetary policy to meet the inflation target in a sustainable way, while supporting output and jobs. In that sense, my key achievements during my MPC terms have been my decisions on the path of monetary policy necessary to achieve these objectives.

Some of the particular issues on which I have focussed during my time on the MPC include:

- The role of *data*, including new and fast indicators, when judging the outlook for the economy, where I have drawn extensively on new data sources and on data science techniques. See, for example, my speech 'Will big data keep its promise?' (2018). These approaches have been particularly valuable recently when tracking the path of the economy, in close to real-time, during the Covid crisis – see, for example, my speech on 'The Second Quarter' on 30 June.

- The role of the *labour market*, in particular the hiring decisions of companies and the moving decisions of workers, when explaining the pre-Covid employment boom at the same time as wage pressures remained subdued. See, for example, my speeches 'Climbing the Jobs Ladder' (2019), 'Pay Power' (2018), 'Work, Wages and Monetary Policy' (2017) and 'Labour's Share' (2015). More recently, I have used the same framework to help understand the risks to jobs in the light of the Covid crisis.

- The *role of productivity* in driving growth and price pressures in the economy, including the causes of its poor performance over the past decade. In particular, I have used firm-level

Completed questionnaire should be returned to the Treasury Committee (treascom@parliament.uk) by **xxxxxxx**, along with a full CV.

data to assess the role (lack of) diffusion, rather than stalling innovation, has played in contributing to this poor performance. See, for example, my speeches 'Productivity Puzzles' (2017) and 'The UK's Productivity Problem: Hub No Spokes' (2018).

- Using historical data to understand the *drivers of economic growth*, in particular the role of innovation and institutions and a broad range of "capitals" (physical, human, intellectual, creative, social). See, for example, my speeches on 'Ideas and Institutions – a Growth Story' (2018), 'Growing, Fast and Slow' (2015), 'The Creative Economy' (2018) and 'The health, wealth and happiness of nations' (2020). Understanding these drivers is critical when considering how, post-Covid, we might "build back better".

- I have done research assessing the impact of *Quantitative Easing* (QE) on activity and inflation in the economy, including the channels through which it operates, the international transmission of QE and the state-dependency of QE. See, for example, the working paper I co-authored, 'QE: the story so far' (2016). This is relevant to current debates about the efficacy of further QE.

- Assessing the *distributional*, as well as the aggregate, effects of monetary policy on different cohorts of society (age, income, region *etc*) and on well-being/happiness across these cohorts. See, for example, my speech 'How Monetary Policy Affects Your GDP' (2018) and my forthcoming working paper, 'Has monetary policy made you happier?' (2020).

- The effects of *competition in product and labour markets* on activity and inflation in the economy and the appropriate setting of monetary policy in response to these developments. See, for example, my Jackson Hole speech on 'Market power and monetary policy' (2018) and subsequent working paper (2019). Covid may also affect these competitive pressures, not least if there is a retreat from globalised markets.

- The importance of *central bank communications*, in particular the role of simpler and more straightforward language in reaching broader audiences. See, for example, my speech, 'A Little More Conversation, A Little Less Action' (2017) and two recent working papers, 'Central Bank Communications and the General Public' (2018) and 'The 3 E's of central bank communication with the public' (2020). I have used survey and experimental evidence to assess the impact of the Bank's simpler "layered" communication in improving understanding and trust among the general public.

- Alongside doing a large number of *regional company visits* (around 40 during my time on the MPC to date) to gather intelligence on the economy, I have undertaken research to assess the economy from a "bottom-up" perspective, using local data and local narratives (see, for example, my speech 'Is all economics local?' (2019)). I have also developed highly granular models of the economy to understand and aggregate these local effects (see, for example, my paper in the *Oxford Review of Economic policy* on 'An interdisciplinary model for macroeconomics' (2018) and in the *Journal of Evolutionary Economics* on agent-based models (2019)).

- The role of broader *outreach*, to audiences beyond the conventional ones, when explaining the economy and when gathering intelligence on how it is doing. I have over the past three years led the Bank's Townhall Meetings, Community Forums and Citizens' Panels, engaging charities, community and faith groups and citizens directly across the UK, often focussing on less well-performing parts of the UK. See, for example, my speeches on 'Climbing the Public Engagement Ladder' (2018), 'Folk Wisdom' (2018) and a TEDx talk. These initiatives are now being taken forward Bank-wide. As well as improving the Bank's reach and accountability, I have found these events to be an invaluable source of intelligence on the most important economic issues facing people. See, for example, our recent report, 'The UK economy: insights from the Bank of England Citizens' Panels'. The Bank's new online Citizens' Panel forum has recently provided useful intelligence on the impact of the Covid crisis on peoples' lives, jobs and incomes.

- I co-lead the Bank's *education* efforts, including the development of schools curriculum materials for 11-16 years old (EconoMe) and, most recently, 8-11 years olds (Money and Me, developed jointly with the TES and Beano). This is part of a broader effort by the Bank to improve understanding of its role and the economy and financial system – see, for example, my speech 'Everyday Economics' (2017).

Although only indirectly related to my MPC role, I have also done research, among others things, on:

- Issues of diversity, including estimating pay gaps (see, for example, a working paper on 'Understanding pay gaps' (2020) and a speech, 'The Sneetches' (2016)).
- Issues around Central Bank Digital Currencies (CBDC) and their potential impact on monetary and financial stability.
- Issues around financial stability, including the impact of regulatory reforms since the Global Financial Crisis and in the light of the Covid crisis (see, for example, my paper on 'Rethinking Financial Stability' (2018) and a forthcoming paper in the *Oxford Review of Economic Policy*).

4. *What do you regard as the main challenges you will face as Chief Economist in the next three years?*

Overwhelmingly, the main challenge over the next three years for the MPC is likely to continue to be assessing the on-going effects of the Covid crisis on output, jobs and inflation and to set monetary policy in the light of this to meet the MPC's statutory objectives.

Some of the main issues are likely to include:

- Operating monetary policy at a time when many paths for the economy are possible, in both the short and longer-run.
- Gauging how the evolution of the virus, and policy responses to it, will affect the behaviour of households and businesses, in particular their degree of precautionary saving.
- Understanding the evolving dynamics of the labour market, including sectoral and skill shifts in the economy which might affect employment and wage growth.
- Assessing the risk of scarring to the economy as a result of Covid-19 - for example, due to business investment and dynamism falling (affecting physical capital accumulation) and/or human skills depreciating (affecting human capital accumulation).
- Assessing the balance of factors, on both the demand and supply sides of the economy, shaping the future inflation outlook, including the path of inflation expectations.
- In a world of low equilibrium interest rates, assessing which monetary instruments are likely to have the greatest traction and how best to implement and combine these measures.

Completed questionnaire should be returned to the Treasury Committee (treascom@parliament.uk) by **xxxxxxx**, along with a full CV.

- Addressing concerns about "monetary financing" of fiscal deficits through QE.
- Ensuring the MPC's actions, and public understanding of these actions, are communicated clearly and comprehensively and rooted in adherence to the inflation target.
- Continuing to improve and widen monetary policy communications, at a time of acute uncertainty about the economy.
- Assessing the rise, and potential role, of digital currencies, including private ones, in shaping the monetary policy transmission mechanism.

5. *What are your research priorities for the next 3 years?*

The Bank's research agenda for the next few years will include a specific priority theme on the monetary policy toolkit. In an environment of low equilibrium interest rates, central banks will have to consider a wider set of instruments to meet their remits. This throws up important questions about how these new instruments work, how they interact with each other, and which ones should be deployed when. Central banks should also analyse whether these tools will have distributional effects and how best to communicate them to the general public.

B Monetary and economic policy

6. *Given the impact of the corona virus pandemic on the economy, what is your outlook for inflation over the next three years?*

CPI inflation in May was well below the inflation target, at 0.5%. This is largely the result of the weakness of energy prices which are temporarily weighing on measured CPI inflation, together with some effects from weak demand. Inflation is likely to fall further in the second half of the year, in part due to the effects of on-going weaker demand. A number of these effects can be directly or indirectly linked to the Covid crisis.

Moving into 2021, inflation should start to pick up back towards its target. That will in part be the result of this year's falls in energy prices dropping out of the annual inflation rate, and in part the result of the recovery of demand in the economy. In the illustrative scenario published by the Bank in its May *Monetary Policy Report*, inflation was back at target by year three.

The degree of uncertainty around the outlook for inflation is greater than usual at present. There are significant forces acting on inflation in both directions. On the one hand, high degrees of uncertainty and risk aversion on the part of households, businesses and financial markets, and the weakness of demand and employment, is likely to dampen wage and price pressures for the foreseeable future.

On the other, the Covid crisis has also severely hit the supply side of the economy. For example, there has been some fracturing of domestic and global supply chains, raising the costs of some goods and services. And it is possible a higher long-term equilibrium rate of unemployment could cause the earlier re-emergence of wage pressures. In addition, an unprecedented degree of monetary and fiscal stimulus has been provided to the UK and global economies recently.

The precise impact on the inflation rate of the balance of these factors is, at present, difficult to gauge. That is why the MPC is monitoring closely, among other things, measures of inflation expectations among households, companies and financial markets.

7. *What do you think is the outlook for wages, productivity and unemployment over the next three years as we deal with the effects of the crisis?*

Total Average Weekly Earnings (AWE) are currently growing at 1.0% at an annual rate. Wage growth is being depressed, temporarily, by the Government's Job Retention Scheme which covers up to 80% of wages. Without that scheme, however, wage growth would probably be weaker still due to a potentially large number of workers being made unemployed.

Looking ahead, the path of wages will depend, among other things, on the degree of slack in the labour market, including the gap between the actual and the equilibrium rates of unemployment. Both are likely to be affected by the Covid crisis.

The Covid crisis is already affecting unemployment. There have been around 2 ½ million extra claims for Universal Credit since the crisis began and the claimant count measure of unemployment has risen by around 1 ½ million people. With over 9 million jobs furloughed, and a further 2 ½ million self-employed workers claiming income support, there is a risk unemployment could rise sharply to levels last seen in the early 1980s. In the MPC's illustrative scenario in May, unemployment rose to a peak of around 9%.

The Covid crisis has affected sectors of the economy differently and, most likely, will continue to do so. This gives rise to the possibility of skills and jobs mismatches across the economy. If these persist, they would raise the equilibrium rate of unemployment at which wage pressures re-emerge, and shrink the degree of slack in the economy. The MPC will be doing further analysis on the balance of these demand and supply factors in the labour market and their implications for pay.

8. *How would you compare the coronavirus crisis to the Financial Crisis in 2008?*

Both crises share the characteristic that they have been associated with a sharp contraction in activity and significant rises in unemployment in the economy.

In other respects, however, the two crises differ significantly. The contraction in activity during the Covid crisis has been steeper and speedier, largely as a result of the necessary imposition of social distancing measures by the Government to contain the spread of the virus. As these measures are relaxed, however, it is likely the recovery from the Covid crisis will be faster than followed the Global Financial Crisis. Early indications are consistent with this hypothesis (see, for example, my recent speech, 'The Second Quarter').

Whether that rapid pace of recovery will continue in future will depend on a number of factors. The recovery from the financial crisis was slow because of impairment to the balance sheets of the financial sector, which reduced its willingness to extend credit. With the financial sector's balance sheet repaired and resilient, this dynamic is not operating this time. Indeed, the UK banking system has already provided tens of billions of pounds in loans to companies to cover their cashflow shortfalls during the Covid crisis, assisted by various Government loan guarantee programmes.

Against that, there are other behavioural factors that could slow the speed of the recovery from the Covid crisis. First, over-leverage in the corporate sector could reduce firms' willingness to invest and hire. Second, relatedly, there is the possibility of widespread corporate failure, or redundancies, if demand does not recover sufficiently rapidly, as recent events attest. Third, there is the possibility of a prolonged period of precautionary saving behaviour by companies and households, due to fears about health and/or unemployment risks, suppressing demand.

The MPC is monitoring these developments closely.

Completed questionnaire should be returned to the Treasury Committee (treascom@parliament.uk) by **xxxxxxx**, along with a full CV.

9. To what extent do you think there will be economic scarring from this crisis?

There will inevitably be some long-term scarring of the economy as a result of the Covid crisis. One of the aims of public policy in the current environment, including monetary policy, is to limit the extent of that scarring. This is best done by measures which shorten the duration, and limit the depth, of the downturn. Indeed, this explains the speed and scale of the monetary and fiscal response to the Covid crisis.

The two key channels through which scarring of the economy's longer-term potential might arise is through reduced business investment and dynamism, hitting the stock of physical capital, and through high unemployment depleting the skills of the workforce and shrinking the stock of human capital.

In the MPC's illustrative scenario published in May, it was assumed that scarring of businesses resulted in the productive capacity of the UK economy being persistently lower by around 1¼%. There was little assumed scarring of the labour market. In practice, there is the potential for scarring effects in the labour market – for example, if sectoral or skills mismatches between workers and companies make it difficult for people to find new jobs, raising the economy's equilibrium rate of unemployment and lowering its productive potential.

Whether the economy experiences scarring, through businesses or workers, will depend on the actions taken by firms, as well as on policy actions taken by Government.

10. Would you support negative interest rates and, if so, what would be the economic indicators that would trigger your support for them on the Monetary Policy Committee?

The MPC does not rule out monetary policy options as a matter of principle. This has underpinned the work of the MPC throughout my time on the Committee, with on-going work to assess and implement various monetary policy tools, some of them new.

For example, until the Brexit Referendum in 2016 the MPC's view was that the "Effective Lower Bound" (ELB) on interest rates, balancing the costs and benefits, stood at 0.5%. Following a review of the evidence, in particular the greater strength of the financial system, the MPC lowered its estimate of the ELB to "close to, but slightly above, zero" in 2016, and cut Bank Rate to 0.25% after the Brexit Referendum.

A similar review is underway at present on the costs and benefits of lowering the ELB further, potentially into negative territory. This will draw on international experience of negative rates and will, as in 2016, assess the impact of lower rates on the financial sector's profitability and willingness to lend. It will also assess whether negative rates are likely to get passed-through to borrowers and depositors and their impact on the confidence of households and companies.

At the same time, it is important to recognise that reviewing and doing are quite different things. Even if the review concluded that the balance of costs and benefits favoured negative rates, it would take time operationally to put them in place, as other countries have found.

There is also work underway on other potential instruments available to the MPC – for example, further rounds of QE, credit-easing policies and forward guidance.

11. *Are there circumstances where you might tolerate higher than target inflation for wider economic reasons? If inflation rises as a result of this crisis and before the economy has recovered how should the MPC react?*

The UK operates a monetary policy regime of so-called *flexible* inflation targeting. The MPC's remit gives it the flexibility, in exceptional circumstances, to bring inflation back to target more slowly than usual, if doing so reduces the volatility in activity and jobs.

The MPC has made use of this flexibility following previous large shocks to the UK economy – for example, in the aftermath of the Global Financial Crisis and the Brexit referendum. In both cases, sterling fell sharply and inflation rose above the target. But monetary policy was nonetheless loosened to support the economy and jobs, with inflation returned to target more slowly to reduce the volatility in output and jobs. That same flexibility could be used by the MPC in future, if inflation were to rise sharply at a time when activity remained subdued.

12. *The UK economy will emerge from this crisis with a much larger public debt and Bank of England balance sheet, and with the latter holding much of the former. What challenges, if any, does this present to Bank of England independence and its control of inflation?*

The balance sheets of both the Government and the Bank of England have expanded materially since the Covid crisis and are likely to continue to do so in the period ahead. This is unsurprising. Both have been affected by a common shock – the collapse in the economy resulting from the Covid crisis. For good reasons, this caused both fiscal and monetary policy to expand rapidly and significantly to cushion the effects of the crisis on activity and jobs.

But the coincidence of these balance sheet expansions in no ways implies causality. There is no sense in which expansive fiscal policy has "caused" the monetary expansion. And nor is there any sense, other than in the arithmetic one, in which there has been "monetary financing" of the fiscal deficit. These misperceptions inaccurately blur the boundary between monetary and fiscal policies.

The key safeguards against any blurring of this boundary are, first, the MPC's on-going commitment to the inflation target and, second, the UK's institutional arrangements for the setting of monetary policy, in particular the operational independence of the MPC. With these in place, the risks of so-called "fiscal dominance" of monetary policy are negligible.

13. *What data and modelling difficulties has the crisis presented to the Bank?*

The Covid crisis has increased difficulties around data and modelling of the economy. On the data side, and as the Office for National Statistics (ONS) have made clear, the crisis has made it difficult to collect and interpret some statistics, including on prices, employment and activity in the economy.

On the upside, the Bank, the ONS and other agencies have made a significant investment in a range of "fast indicators" to monitor developments in the economy. Some of these are described in the Bank's May *Monetary Policy Report* and in my recent speech, 'The Second Quarter'. These have provided close to real-time tracking of the economy and have been a good source of intelligence on both the fall in economic activity and its subsequent recovery.

It seems likely that, after the Covid crisis has abated, these higher-frequency, higher-granularity indicators will remain an essential part of the Bank's monitoring toolkit of the economy.

On modelling, the MPC draws on a suite of modelling approaches when understanding the economy and developing its forecasts. For the scenario published in May, the MPC used bottom-up, sectoral analysis to assess the near-term path of the economy, alongside its conventional approaches. The

Bank also drew on detailed, firm-level, analysis of balance sheet positions (Financial Stability Report (May 2020)). This granular and sectoral approach is likely to be used on an on-going basis to assess the path of the economy, given the impact of the Covid shock is sector-specific.

The Bank, alongside academics, has been investing in frameworks which fuse together economic and epidemiological models – so-called epi-macromodelling (for example, Eichenbaum, Rebelo and Trabandt (2020)). These enable interactions between health and economic risks to be assessed. They are proving a valuable addition to the Bank's modelling toolkit.

14. How do you think the current crisis will affect the international economy, including trade?

We have seen evidence during the Covid crisis of the fracturing of global supply chains. There has been some impairment of domestic supply chains too.

It remains to be seen whether this fracturing will persist after the crisis has passed. If it does, this would represent a negative supply shock to the global economy, potentially raising the cost of globally traded goods and services, other things being equal. This is one of the forces potentially bearing on inflation in the period ahead.

Mervyn King said global banks were international in life and national in death. During the Covid crisis, we have found the same to be true of supply chains. In this light, it is understandable that national economies might wish to build greater resilience into these supply chains, particularly for critical goods and services.

15. What is your current view of the short- and long-run impact of the coronavirus crisis on household saving and consumption?

A number of factors are at play here.

In the very near-term, households in aggregate are likely to have seen their savings ratios rise involuntarily, as social distancing and other policies have resulted in a sharper contraction in spending than in income. For example, households' and businesses' deposits with banks have risen by around £120bn since the onset of the crisis. There is, though, likely to have been quite different patterns of savings across different income cohorts, with evidence from the Bank's surveys with Ipsos Mori suggesting that, while better-off household have saved more, poorer ones have had to run down their savings to maintain spending.

Having fallen sharply during March and early April, since the middle of April we have seen all categories of consumer spending recovering, albeit from low levels. The largest rise has been in so-called delayable spending, on things such as DIY and household goods. There has also been a recovery in the other components of consumer spending, including work-related spending and social spending.

In part this recovery appears to have reflected the easing of lockdown restrictions, and in part it appears to reflect greater underlying strength in spending, consistent with a rise in consumer confidence and some pent-up demand. Overall, consumer spending has recovered somewhat sooner, and materially faster, than in the Bank's May scenario. The same patterns of recovery have been seen among the UK's main trading partners.

Looking to the second half of the year, there are two possible paths for saving and demand. If spending continues to recover rapidly, this will reduce risks from unemployment and mitigate any rise in savings by households and businesses for precautionary reasons. This positive feedback loop would pose upside risks to the economic and inflation outlook.

Completed questionnaire should be returned to the Treasury Committee (treascom@parliament.uk) by **xxxxxxx**, along with a full CV.

It is also possible, however, that rising rates of unemployment cause households to raise their levels of precautionary savings, depressing demand and inflation in a negative feedback loop. In its May *Monetary Policy Report*, the MPC judged that the balance of risks to its illustrative scenario lay to the downside. While still skewed to the downside, I judge those risks to be somewhat more evenly-balanced than in May. The MPC will continue to assess the balance of these risks in the period ahead.

16. To what extent do you see forward guidance as a useful tool in monetary policy?

I think forward guidance, on the likely course of the economy and on possible paths for monetary policy, can play a useful role in improving transparency about monetary policy and, potentially, in helping shape the monetary policy stance. For example, at present the MPC is offering forward guidance that it will maintain monetary conditions at levels necessary to support the economy and return inflation to its target on a sustainable basis.

Forward guidance has its limits, however, and it is important these are recognised. Forward guidance cannot offer a promise on the path of monetary policy because this ultimately depends on the path of the economy. Unconditional, or time-dependent, forward guidance should in general be avoided for these reasons.

In the current environment, with the yield curve close to zero across the maturity spectrum, forward guidance potentially has a role to play in maintaining the accommodative monetary conditions necessary to support the economy. This has some similarities with so-called yield curve control.

17. What communication challenges has the crisis presented to the MPC?

The key communication challenge for the MPC in the period ahead will be to set out its views on the path of the economy, and on the monetary policy measures necessary to achieve its objectives, at a time of acute economic uncertainty. This will be done through its usual communications channels, including Minutes of MPC meetings, the *Monetary Policy Report* and MPC speeches and briefings.

Regular MPC communications are particularly important when economic uncertainty is high. To that end, I and other MPC members have given many webinar briefings on the economy since the Covid crisis to audiences across the UK.

In addition to these general uncertainties about the economy, there are a number of specific communication challenges facing the MPC at present.

First, the crisis has resulted in UK interest rates falling towards the ELB. This has raised questions about the appropriate choice of monetary instruments and how they might most effectively be combined. These issues are the subject of on-going review and the MPC will communicate its views on them in due course.

Second, there has been external commentary about the risk of "monetary financing" by the MPC through its QE programme. The MPC has sought to correct these misperceptions and will continue to do so, as discussed above.

A third communications challenge is ensuring the limits to monetary policy are understood. For example, the crisis has brought about sharp shifts in the sectoral pattern of output in the economy, and the skills that might be required. These are important shifts in the supply-side of the economy that could raise the economy's equilibrium rate of unemployment. While these are very important economic issues, they are not ones monetary policy can do much about.

Completed questionnaire should be returned to the Treasury Committee (treascom@parliament.uk) by **xxxxxxx**, along with a full CV.

At this time of momentous uncertainty about the health of societies and economies, it is more important than ever that monetary policy is not over-burdened and that the anchor of price stability is not disturbed.

Completed questionnaire should be returned to the Treasury Committee (treascom@parliament.uk) by **xxxxxxx**, along with a full CV.