## Questionnaire in advance of Treasury Committee hearing
## Dr Gertjan Vlieghe

***Personal and professional background***

*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 MPC?*

No

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

Yes

*3. How has your experience to date equipped you to fulfil your responsibilities as a member of the MPC? In particular, which areas of the MPC's work do you feel especially capable of contributing to, and which will require you to undertake additional research?*

I have been analysing UK macroeconomic data and thinking about UK monetary policy for the past 17 years.

For the past eight years I was a partner and senior economist at Brevan Howard, an asset management firm. I was responsible for analysing the economic outlook for the UK, Canada, Australia and New Zealand. My responsibilities included forecasting key economic data, central bank policy rates and exchange rates. I also worked on cross-country thematic macroeconomic research.

Prior to that, I worked at Deutsche Bank for two years as a fixed income strategist. My responsibilities were to analyse and forecast movements in the UK yield curve.

From 1998 to 2005 I worked at the Bank of England as an economist. I provided analysis and published research on money and credit aggregates, and the impact of corporate, household and bank balance sheets on the economy. I was also the Economic Assistant to the Governor in 2004 and 2005, providing research and policy advice for Governor Mervyn King on the economy and monetary policy strategy.

I hold a PhD in Economics from the London School of Economics. My thesis was on the interaction between imperfect credit markets and monetary policy.

*4. Which of your publications or papers are of most relevance to your future work on the MPC?*

All of my research, published and unpublished, has been relevant for monetary policy. Some examples are:

“House prices, consumption, and monetary policy: a financial accelerator approach,” Journal of Financial Intermediation, vol 13(4), 2004, (with Kosuke Aoki and James Proudman).

“The roles of expected profitability, Tobin's Q and cash flow in econometric models of company investment,” IFS Working Papper 04/12, 2004 (with Steve Bond, Alex Klemm, Rain Newton-Smith and Murtaza Syed)

“Imperfect credit markets: implications for monetary policy,” Bank of England Working Paper (385), 2010.

*5. What other work commitments do you expect to maintain in addition to membership of the MPC, and how will those benefit your work on the MPC?*

I have not decided yet. I will explore part-time teaching or research opportunities in economics, in areas that are relevant to my responsibilities on the MPC.

***Openness, accountability and performance***

*6. How important do you think it is for MPC members to be subject to ex-post parliamentary accountability? What do you think are the strongest and weakest parts of the current accountability procedures in the UK?*

I think it is crucial for MPC members to be subject to ex-post parliamentary accountability, and I look forward to explaining my views and decisions before Treasury Committee.

The Bank of England has operational responsibility for monetary policy, to meet a target that is set by the government. Because monetary policy decisions are therefore taken by unelected officials, the Bank of England derives its democratic legitimacy from having to explain to elected officials why its actions are consistent with the objectives it was given via a democratic process.

The strongest part of the accountability procedure is the “one member, one vote” principle. Combined with the publication of MPC members’ voting records, this allows parliament to hold each MPC member to account individually.

Accountability is closely related to transparency. The more transparent the MPC can be about its processes – without hindering members’ ability to freely discuss market-sensitive matters and test ideas – the better it can be held accountable for those decisions.

The transparency of the MPC, and therefore its accountability, has improved over time as the understanding of central banking best practice has evolved, and will no doubt continue to be improved in the future.

The most recent improvements have been the more timely publication of the minutes, a more detailed presentation of the forecast and its key judgements, and the publication (with a suitable lag) of full transcripts of the MPC decision meeting.

*7. What activities do you intend to undertake in order to add to the public's understanding of the role and decisions of the MPC? Were your opinion to differ from the majority, would you be prepared to explain publicly the reasons for your dissent?*

In addition to giving evidence to the Treasury Committee, I intend to make on-the-record speeches, give interviews to the press and meet regularly with a range of businesses and other organisations, such as charities and educational organisations These regional visits are an important opportunity for the MPC to communicate its decisions and decision process, and meetings with local businesses also to allow MPC members to gather important information about the state of the economy.

If my opinion differed from the majority, this would become clear through my vote. I would use all the communication channels I have just mentioned to explain my dissent.

*8. Do you believe that there is merit in having individual paragraphs in the minutes of MPC decisions in which members can explain their votes?*

There is a trade-off between being clear and being comprehensive. No two MPC members are likely to agree on all aspects of the economic and policy outlook, even if their vote is the same. While there is merit in allowing an explanation for dissenting votes, as is current practice, I think there is a risk of confusion if all members are given their own paragraph in the minutes, even when they agree on the broad outlines of the outlook. Subtle points of difference can be more effectively communicated, if necessary, in speeches, interviews and appearances before the Treasury Committee.

*9. What do you think will be the main challenges the MPC will face in the next three years? What criteria do you suggest should be used to assess your individual record as an MPC member?*

The MPC has provided an unprecedented amount of monetary stimulus, to counter unprecedented headwinds to the economy. The MPC faces numerous difficult judgements:

First, how much slack remains in the economy.
Second, to what extent the headwinds to growth and inflation are persisting or abating. This question relates to the interest rate that will be appropriate once slack in the economy has been absorbed.
Third, which combination of interest rates and asset sales will provide the optimal path of policy normalisation once normalisation becomes appropriate.

I suggest my individual record as an MPC member should be judged on the path of inflation and inflation expectations, on how I have voted, and on how well I have communicated the judgements underlying my vote.

***Monetary and economic policy***

*10. What do you regard as the major risks to the outlook for the UK economy?*

The UK has performed relatively strongly in the past two years in an environment of rather disappointing global growth, which is weighed down by high debt and weak demographics.

Given the UK's important trade and financial links to the global economy, there is probably a limit on the extent to which the UK's economic performance can diverge from that of the global economy. So one major risk is that global growth continues to disappoint, and that this would pull UK growth down, both via investment and exports.

While the household debt to income ratio in the UK has come down, it remains elevated. Two risks arise from this situation. First, it may be that household consumption remains more sensitive to income shocks than it has been historically. Second, it may be that household consumption is more sensitive to interest rate increases than it has been historically.

Inflation is currently very weak. Headline inflation is close to zero, core inflation is only around 1%, and unit wage costs are growing at a pace that is lower than what is required for meeting the inflation target in the medium term. There are good reasons to expect some rise in inflation on some of these measures in the coming quarters. Such a rise is necessary in order to be confident of meeting the inflation target at the policy horizon. There are risks to either side, but given the current low levels of inflation the risks are probably skewed to the downside.

*11. What do you think explains the UK's 'productivity puzzle'?*

No single explanation fits all of the facts. We know that weak productivity and output performance after a financial crisis is a statistical pattern that has been observed in many other countries, both in the most recent crisis as well as in previous ones.

A combination of weak investment, reduced availability of credit early on in the crisis, reduced demand for investment as firms focused on repairing their balance sheets and were reminded about the risks of extreme events, as well as reduced flows of capital and workers to their most productive uses are all likely to be part of the explanation. It is useful to expand on each of these points.

First, early on in the crisis, banks withdrew credit sharply as they themselves faced funding and solvency strains. This sharply reduced business investment, but probably also significantly diverted management time away from normal production toward securing new sources of financing. There is ample evidence of that mechanism: simple surveys that ask whether credit availability is a constraint on investment and output went up sharply, and formal econometric evidence shows that firms whose banks cut credit the most faced sharper output and productivity contractions.

Second, as the economy moved from its acute contraction phase to a rather subdued initial recovery, credit constraints likely remained tight as banks were in balance sheet repair mode. Firms adapted to the new environment by seeking out bank financing from banks that were in a relatively stronger position, a process that takes time and effort. Firms also reduced bank finance in aggregate and replaced it with bond and equity finance. None of these difficult transitions were conducive to making productivity-enhancing investment in technology, capital or people.

Third, in addition to thinking about the ability and willingness of firms to invest in aggregate, it is also useful to think about the normal flows of workers and capital between firms. In a well-functioning economy, there are large gross flows of resources between firms, as productive firms expand and less productive firms shrink. After the crisis, there was and continues to be an unusually high dispersion in the productivity across firms, suggesting the normal process of resources flowing towards their most productive use was impaired.

Fourth, there is evidence of the impact of so-called “disaster risk” or “extreme event risk”. After the crisis, firms were reminded that there is a risk of rare but very sharp contractions. Taking such risk into account means that, even with very low risk-free interest rates, firms require very high rates of return before undertaking new investment.

Fifth, there is the question of whether technological progress, which is itself subject to long cycles, was already slowing before the crisis. This is related to deep unresolved questions about whether we have already invented everything that is useful – unlikely I think – or whether we are on the verge of a new age of rapid productivity advancements as we learn how to make good use of a wide range of new technologies that are not yet in widespread use.

I also note that aggregate labour and output are very difficult to measure and the data are subject to substantial revisions over time. Revisions in the past few years have generally been upwards when it comes to productivity.

*12. What consideration do you think should be given to asset prices, including house prices, within the framework for inflation targeting? In particular, how should monetary policy react to asset price bubbles, and does the current MPC remit provide sufficient scope for such action?*

Asset prices play two important roles for monetary policy.

First, asset prices contain useful information, for example about the profit expectations of firms, the income expectations of households, and inflation expectations of financial market participants. Since current spending decisions are based in large part on expectations about the future, it is important to pay attention to any indicators that provide information about these expectations.

Second, asset prices can affect the economy directly via collateral effects. As asset prices rise, borrowers have more collateral available, lenders become more willing to lend, and this can have an independent effect on spending, over and above the effect of expectations alone.

Central banks do not necessarily have better insights than firms, households or banks on what constitute the “right” level of an asset price and what constitutes a bubble. But central banks can put policies in place to ensure that, if it turns out the asset price was wrong, the resulting correction does not cause financial and economic instability.

The FPC has direct tools to deal with such problems. Circumstances may also arise when the MPC may want to choose a faster or slower path for inflation to return to target, to minimise the risk of economic instability. The MPC remit already allows for that.

*13. What is your assessment of the effectiveness of the policy of quantitative easing in the UK? What, in your view, are the principal challenges of unwinding quantitative easing?*

Quantitative easing was a necessary and useful additional stimulus tool when the policy rate had reached its effective lower bound. Its effectiveness is difficult to measure with any kind of precision, but all of the empirical analysis points to it having had a significant impact on asset prices. In turn, that means it is likely to have had an effect on growth and inflation via a range of channels: the term structure of interest rates, credit spreads, equity prices and the exchange rate.

It does appear that later phases of quantitative easing had a smaller impact than earlier phases.

There are two challenges in relation to the unwinding of quantitative easing: one related to transition, and one related to the new steady state.

The transition challenge is that we do not know precisely what the effect on the economy and on asset prices will be of any potential asset sales. A prudent approach, therefore, would be to sell the assets over a long period of time, and to begin asset sales only after interest rates have been raised well above their effective lower bound. That will allow interest rates to be used as the active monetary policy tool that can respond to the changing outlook, while asset sales are being unwound steadily.

The steady state challenge is that we do not know what quantity of reserves banks will desire. Currently the aggregate level of reserves is effectively determined by the MPC’s asset purchase decisions, ie it is supply-driven. At some stage we might go back to a demand-driven reserves system, as discussed in the Winters Review. But the regulatory environment has changed significantly, so banks are likely to demand a higher level of reserves than before the crisis, to help meet higher liquidity requirements. The quantity of reserves demanded by banks can be achieved in many ways. The reserves can be lent to the banks for short rolling periods, with rather lower outright holdings of assets by the Bank of England. Or reserves can be supplied more permanently, which would involve larger asset holdings by the Bank of England. These choices will therefore affect the quantity of assets that the Bank of England needs to sell.

*14. Are there circumstances where you might tolerate higher or lower than target inflation for wider economic reasons?*

A rate of inflation that is permanently higher or lower than the target is inconsistent with the Bank of England's price stability mandate for 2% CPI inflation, which is symmetric and applies at all times, and would endanger the stability of inflation expectations.

A rate of inflation that temporarily higher or lower than the target can be justified for economic reasons, provided the MPC communicates those reasons clearly, so that longer-term inflation expectations remain stable.

Some economic disturbances bring about a short run trade-off between stabilising inflation and economic activity. The experience of above-target inflation and below equilibrium employment during the financial crisis is one such example. The MPC's remit recognises that, in such circumstances, it may be appropriate to set policy in order to return inflation to target over a longer period than would be the case in the absence of such a trade-off. Although such trade-offs can and do arise, a credible inflation targeting framework such as the UK's helps ameliorate their severity by ensuring that medium-run inflation expectations remain well anchored.

Other circumstances might include a desire to minimise the build-up of internal or external imbalances, which might otherwise lead to increased risk of a disorderly unwind that brings about economic and financial instability, with consequences for the MPC's price stability objective. Although in such circumstances, it is more likely that an FPC policy response would be the first line of defence.