House of Commons
Treasury Committee

Appointment of Charlie Bean as Deputy Governor of the Bank of England

Fifteenth Report of Session 2007–08

Volume II

Oral and Written Evidence

Ordered by the House of Commons to be printed 2 July 2008

HC 917–II
Published on 23 July 2008
by authority of the House of Commons
London: The Stationery Office Limited
£4.50

The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

Current membership

Rt Hon John McFall MP (*Labour, West Dunbartonshire*) (Chairman)
Nick Ainger MP (*Labour, Carmarthen West & South Pembrokeshire*)
Mr Graham Brady MP (*Conservative, Altrincham and Sale West)*
Mr Colin Breed MP (*Liberal Democrat, South East Cornwall*)
Jim Cousins MP (*Labour, Newcastle upon Tyne Central*)
Mr Philip Dunne MP *(Conservative, Ludlow)*
Mr Michael Fallon MP (*Conservative, Sevenoaks*) (Chairman, Sub-Committee)
Ms Sally Keeble MP (*Labour, Northampton North*)
Mr Andrew Love MP (*Labour, Edmonton*)
Mr George Mudie MP (*Labour, Leeds East*)
Mr Siôn Simon MP, (*Labour, Birmingham, Erdington*)
John Thurso MP (*Liberal Democrat, Caithness, Sutherland and Easter Ross*)
Mr Mark Todd MP (*Labour, South Derbyshire*)
Sir Peter Viggers MP (*Conservative, Gosport*).

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No. 152. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at www.parliament.uk/treascom.

A list of Reports of the Committee in the current Parliament is at the back of this volume.

Committee staff

The current staff of the Committee are Colin Lee (Clerk), Sîan Jones (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young and Jay Sheth (Committee Specialists), Phil Jones (Committee Assistant), Caroline McElwee (Secretary), Tes Stranger (Senior Office Clerk) and Laura Humble (Media Officer).

Contacts

All correspondence should be addressed to the Clerks of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee’s email address is treascom@parliament.uk.

Witnesses

Wednesday 2 July 2008

List of written evidence

List of Reports from the Treasury Committee during the current Parliament

Session 2007–08

First Report	The 2007 Comprehensive Spending Review	HC 55
Second Report	The 2007 Pre-Budget Report	HC 54
Third Report	The Work of the Committee in 2007	HC 230
Fourth Report	Climate change and the Stern Review: the implications for Treasury policy	HC 231
Fifth Report	The run on the Rock	HC 56
Sixth Report	Financial Stability and Transparency	HC 371
Seventh Report	Administration and expenditure of the Chancellor's departments, 2006–07	HC 57
Eighth Report	Re-appointment of Dr Andrew Sentance to the Monetary Policy Committee	HC 454
Ninth Report	The 2008 Budget	HC 430
Tenth Report	Re-appointment of Mervyn King as Governor of the Bank of England	HC 524
Eleventh Report	Counting the population	HC 183
Twelfth Report	Inherited Estates	HC 496
Thirteenth Report	Budget Measures and Low-Income Households	HC 326
Fourteenth Report	Appointment of Lord Turner of Ecchinswell as Chairman of the Financial Services Authority	HC 916
Fifteenth Report	Appointment of Charlie Bean as Deputy Governor of the Bank of England	HC 917

Session 2006–07

First Report	Financial inclusion: the roles of the Government and the FSA, and financial capability	HC 53
Second Report	The 2006 Pre-Budget Report	HC 115
Third Report	Work of the Committee in 2005–06	HC 191
Fourth Report	Are you covered? Travel insurance and its regulation	HC 50
Fifth Report	The 2007 Budget	HC 389
Sixth Report	The 2007 Comprehensive Spending Review: prospects and processes	HC 279
Seventh Report	The Monetary Policy of the Bank of England: re-appointment hearing for Ms Kate Barker and Mr Charlie Bean	HC 569
Eighth Report	Progress on the efficiency programme in the Chancellor's department	HC 483
Ninth Report	Appointment of the Chair of the Statistics Board	HC 934
Tenth Report	Private equity	HC 567
Eleventh Report	Unclaimed assets within the financial system	HC 533
Twelfth Report	The Monetary Policy Committee of the Bank of England: ten years on	HC 299
Thirteenth Report	Financial inclusion follow-up: saving for all and shorter term saving products	HC 504
Fourteenth Report	Globalisation: prospects and policy responses	HC 90

Session 2005–06

First Report	The Monetary Policy Committee of the Bank of England: appointment hearings	HC 525
Second Report	The 2005 Pre-Budget Report	HC 739
Third Report	The Monetary Policy Committee of the Bank of England: appointment hearing for Sir John Gieve	HC 861
Fourth Report	The 2006 Budget	HC 994
Fifth Report	The design of a National Pension Savings Scheme and the role of financial services regulation	HC 1074

Sixth Report	The administration of tax credits	HC 811
Seventh Report	European financial services regulation	HC 778
Eighth Report	Bank of England Monetary Policy Committee: appointment hearing for Professor David Blanchflower	HC 1121
Ninth Report	Globalisation: the role of the IMF	HC 875
Tenth Report	Independence for statistics	HC 1111
Eleventh Report	The Monetary Policy Committee of the Bank of England: appointment hearings for Professor Tim Besley and Dr Andrew Sentance	HC 1595
Twelfth Report	Financial inclusion: credit, savings, advice and insurance	HC 848
Thirteenth Report	"Banking the unbanked": banking services, the Post Office Card Account, and financial inclusion	HC 1717

Oral evidence

Taken before the Treasury Committee

on Wednesday 2 July 2008

Members present

John McFall, in the Chair

Nick Ainger	Mr Michael Fallon
Mr Graham Brady	Ms Sally Keeble
Mr Colin Breed	Mr Andrew Love
Jim Cousins	Mr Mark Todd
Mr Philip Dunne	

Witness: **Charlie Bean,** Deputy Governor for Monetary Policy at the Bank of England**,** gave evidence.

Q1 Chairman: Welcome to the Committee of this appointment hearing. Can you formally introduce yourself?
Professor Bean: Charlie Bean, Deputy Governor for Monetary Policy at the Bank of England.

Q2 Chairman: Some commentators have said you are the Governor's choice, an inside job, it is all a screw up: discuss.
Professor Bean: I am not sure describing it as an inside job is appropriate. What is true is that of internal candidates the Governor did consider that I was suitable for the position, but of course this is an appointment that the Treasury makes and it was a Treasury process.

Q3 Chairman: What is behind my question is how will you convince the City you are the right person for the job?
Professor Bean: The key thing to remember is that this is the Deputy Governor for Monetary Policy not the Deputy Governor for Financial Stability. My core responsibilities are related to monetary policy and ensuring that the Monetary Policy Committee gets the appropriate support from the Monetary Analysis and Statistics, and Markets Directorates and for that the background that I have renders me suitable. Despite my background, I feel that I have a reasonable familiarity with the Markets area, although clearly I will need to acquire additional knowledge and I expect to be aided in that by Paul Tucker, the director. I also expect to try to do more in the way of meeting people from the markets and from the City more generally. My links so far have been more concentrated narrowly amongst the economists.

Q4 Mr Fallon: You will probably be the last Deputy Governor to be appointed without external competition, is that right?
Professor Bean: If that is the case, then I think that would be a move forward. Personally I am all in favour of advertising these positions.

Q5 Mr Fallon: You say in your note, and you have just said to the Chairman, "I also intend extending my circle of personal contacts to include more external market participants". Can you decode that for us? Does that mean having dinner with bankers?
Professor Bean: That will include lunches and dinners with people from the markets and the banking sector generally, yes.

Q6 Mr Fallon: Most of your career seems to have been spent in the Treasury, academia or the Bank itself.
Professor Bean: That is correct, yes.

Q7 Mr Fallon: How do you think the Markets Directorate needs to reinforce its intelligence capacity?
Professor Bean: It has been in the process of building up that capability. One of the objectives that Mervyn set the area when he became Governor was to try to build up that capability. It is still in the process of being built up so there is more to do in that particular line.

Q8 Mr Fallon: But how?
Professor Bean: Part of it is actually increasing the links and actually putting more resources into it.

Q9 Mr Fallon: Do you mean more people?
Professor Bean: Yes.

Q10 Mr Fallon: You also say you want to continue the "leaner but smarter strategy". I am confused as to whether it is more people or fewer people.
Professor Bean: There is a distinction between the Markets Directorate and the Monetary Analysis and Statistics Directorate. Over the past few years, the Monetary Analysis and Statistics Directorate, which is where most of the economists supporting monetary policy are, has been trying to improve experience levels—having fewer, but more experienced, people who can potentially add more value added to the monetary policy support process. Also we are trying to improve the information technology support, so that people are less involved in grudge work and things like that, again to liberate

time for higher value added activities. It is the Monetary Analysis and Statistics Directorate that the "leaner but smarter" strategy refers to.

Q11 Mr Fallon: So fewer economists but more on the market side.
Professor Bean: There has been some rebalancing, yes.

Q12 Mr Dunne: Your appointment has obviously given rise to quite a lot of press speculation, some of it perhaps extending beyond the speculative to personal critiques of you and contending candidates. Do you think it is appropriate for you to be undertaking a job application through the media?
Professor Bean: I personally did not initiate that process. From a personal perspective. I found it pretty disturbing that it was all being played out in the public. As far as possible I have tried to let it wash past me but that is not always easy to do.

Q13 Mr Dunne: Is there anything that can be done to limit that or is that an inevitable fact of life?
Professor Bean: It may be an inevitable fact of the press. Unfortunately they are not something I can control.

Q14 Mr Dunne: Some have described the managerial style within the Bank of England as something akin to that of the monarchy. Do you agree with that assessment and, if so, does that make you the heir apparent?
Professor Bean: It certainly does not make me heir apparent and I would not agree that it is a monarchy either. Mervyn is clearly a strong figure, he has a very good mind, but he is open to persuasion that different approaches are appropriate if you provide the arguments. From the inside it does not look as monarchical or autocratic as perhaps it is painted from the outside.

Q15 Mr Todd: *The run on the Rock* Report that we did highlighted failings in the communications strategy not just of the Bank but the tripartite authorities. You incautiously remarked in your questionnaire that you wanted to focus more on the Bank's communications agenda. Does that suggest you wish to address any shortcomings in that area or do you have some other brief?
Professor Bean: The comments were particularly in relation to communications regarding monetary policy decisions. The Committee will be aware that we are in a period which is much less benign than for most of the period of the MPC's existence, where we are faced with two nasty shocks of unknown magnitude, impact and duration, both of which will be depressing activity but have conflicting impacts on inflation. In those circumstances the MPC's communications through its various channels—the minutes, the Inflation Report, our speeches programme, the open letters—will be particularly important. That was actually something that this Committee itself recognised in its *MPC Ten Years On* Report. In addition, we have a new communications director who has just joined the Bank and that provides a natural trigger for reconsidering our strategy; thinking about what more we can do to make sure we get the message across in a clear and coherent fashion to as wide a community as we need to.

Q16 Mr Todd: Would that include looking at improved education provision related to monetary policy as well?
Professor Bean: That would certainly be within that remit but it is also getting out to the general public as well as the cognoscenti, the community of economists and market commentators and media who follow these things closely. At the current juncture I think reaching out to a broader audience is also deemed to be important.

Q17 Mr Todd: You also have responsibility for the Centre for Central Banking Studies which I interpreted as being an important communication means with other banks around the world in terms of research and educational resource and, therefore, also an important networking mechanism. Is that the view you share?
Professor Bean: Yes, that is a fair comment. It really plays two roles: first, it runs courses for central bankers in other countries—often developing countries, emerging market countries and so forth—and helping them instil good practice; secondly, it acts as a networking facility, a networking organisation, for central bankers in more established jurisdictions. For instance, there is a regular annual Chief Economists' workshop that is held every year which draws chief economists from central banks across the world and which provided a good opportunity for me, in my former role, to meet my counterparts overseas.

Q18 Mr Todd: To some extent it is potentially part of the intellectual hub of the Bank. Is there something that you can bring to maintain the strength of the intellectual base of the Bank in a circumstance in which that is clearly rather more required than it has been for some time?
Professor Bean: I would certainly expect that is where my comparative advantage would lie. If you compare with my predecessor, she clearly had a great deal of experience running large organisations and obviously had experience in monetary policy. Compared to her obviously my relative strength is in an understanding of the intellectual foundations of monetary policy, and that is something that I can inject into the CCBS, as well as other parts of the Bank's activities.

Q19 Mr Love: There has been a lot of debate recently about inflation expectations. Looking through your questionnaire you talk about all the different things that you have been doing: 21 presentations on what the MPC does, a very impressive list. Is there anything more that you can do in your new position to orchestrate the public debate on inflation expectations?

Professor Bean: A key determinant of that are our public communications, vehicles like the Inflation Report in particular, but also speeches and the minutes to a degree, where we can seek to get out the message that, provided pay growth remains subdued, that the current pick-up in inflation should prove to be temporary. Therefore, although it is perfectly reasonable for people's expectations to have shifted up for the next 12 months there is no reason to expect inflation to be higher in the medium term. I would see those as the main vehicles for trying to get that message out.

Q20 Mr Love: You do not see yourself as speaking to a wider audience than currently is normally envisaged, for example someone going and speaking to the TUC conference?
Professor Bean: I can certainly envisage doing that. One of the things I do expect to do is more in the way of public speeches on the record than I did in my role as chief economist. I had a few of those and they were by and large to professional audiences but in my current role I would expect to do more speeches to the broader audience of the sort that you previously mentioned.

Q21 Mr Love: How do you convince the public that most of the inflation experience of the present time is of a temporary nature? Do we just wait and hope that it will come down quickly and we will get over this or is there a role to actually explain that to the public?
Professor Bean: The key is explaining the pre-conditions for it to be temporary. This is based on the presumption that oil prices do not continue to rise inexorably in the way they have—and that may be open to debate—and explaining to people that it is something we can do very little about and is determined by global factors. As a nation it means that our real living standards would be lower than they otherwise would be. Providing we recognise that, the pick up in inflation we currently see should be temporary, providing that pay growth does not pick up to try and compensate for the pick up in overall inflation.

Q22 Jim Cousins: You told us that "employees may struggle to obtain compensation for past and prospective increases in our RPI", that is to say there is going to be a cut in living standards. Why do you think that is happening? How long can we keep it up and what will the consequences be?
Professor Bean: The fact we are facing them is a consequence of what has been happening to global commodity prices particularly oil. That shift in the price of commodities compared to the price of general goods and services is, in essence, the reason why real living standards will have to grow less rapidly this year, and possibly part of next year, than was the case over much of the late 1990s and early 2000s. There is not very much we can do about that as a nation unless we improve our productivity to offset it.

Q23 Jim Cousins: You put it rather differently to us in writing. You did not say that living standards would grow less rapidly; you clearly signalled that they were going to fall and you set out four probable reasons for that: global price pressure, in-migration, the increased scope for offshoring, and the breakdown of the present structure of collective bargaining. How long are we going to have to keep it up and what will the consequences be?
Professor Bean: Firstly, the mechanisms that I am outlining here are four reasons for being optimistic about the development of wages from the point of view of its impact on inflation. You are absolutely right to raise a question of how long can we keep it up, in that it is easier to persuade people to accept a year of relatively low growth, or even cuts, in their real incomes if it is for a year or a relatively short period. But if it is for a number of years running, then clearly that is a much tougher climate both for people at large and also more narrowly for wage bargaining.

Q24 Jim Cousins: What will be the consequences be?
Professor Bean: At the end of the day it goes back to the point I made earlier. If the thing which is driving this are external factors beyond our control, what is happening to global commodity prices as a result of the increase in demand in the rest of the world, that deterioration in the terms of trade, in the technical sense, is something that we will have to accept unless we offset it by somehow generating faster productivity growth to justify paying ourselves more. That is certainly a much less favourable environment to be in than we were in the 1990s when things were going the other way. Then we were getting a beneficial kick to living standards from the ability to buy more cheaply produced manufactured goods from China and other emerging market economies.

Q25 Jim Cousins: You do accept the social consequences of what you have set out are enormous and will not go without reaction even if economically they have to be accepted.
Professor Bean: It certainly poses a significant challenge. There is no doubt about that at all.

Q26 Ms Keeble: Are you concerned about the lack of credibility with the public about the Bank's interest rate figures and inflation figures in that everybody thinks inflation is running at a much higher rate and people cannot get interest rates at the level you set.
Professor Bean: Can I separate the two—the interest rates and inflation—because they are distinct issues? It has always been the case that when we set Bank Rate that is not going to be the same as the rate that mortgage holders pay on their mortgages or that savers get on their savings accounts. There is always a wedge between those rates and our official rate.

Q27 Ms Keeble: But not a chasm?
Professor Bean: What is true is those gaps have become larger but you should remember that the gaps had become smaller during the previous two or

three years. There had been a compression in those spreads and they have now merely widened back to where they were about three years ago. That does not alter the fact that people will notice that their mortgage rate has not gone down, and may even have gone up, at a time when we might have cut our official rate. Obviously we have to factor that into our calculations, when we are making our judgment on where our policy rate should be, how that will affect the rates that are actually paid or received by households and businesses. So that is the interest rate bit. The inflation number is a slightly different issue because inflation refers to a basket of goods and services rather than a single interest rate. For most households they would not know exactly what their inflation rate is and would need to calculate their own inflation basket. The number that the Office for National Statistics produces is a representative number for the economy as a whole. There will be some households who have expenditure weights which are more heavily weighted towards goods that might be rising more rapidly in price and they will have higher inflation rates. And there will be some households where the opposite is true and they will have a lower inflation rate. On top of that, there is a genuine issue in that households will be more aware of the prices of some goods and services than others so things that they buy regularly or things which have particularly high visibility are likely to loom large. The price of petrol is a very good example, and the price of milk, bread and things they buy regularly in the shops they will notice when the prices are changing. On the other hand, things you buy infrequently, a plasma screen TV say, you would not be aware that the price has come down markedly over the past year or two. One of the reasons for the disjunction between people's perceptions of the inflation rate and the true inflation rate is simply that they are effectively putting more weight on the things they buy more frequently and have greater visibility.

Q28 Ms Keeble: If part of your aim is to improve the communication strategy, including communicating with the wider public, are you not going to have to persuade them, or explain and convince and regain the credibility around the figures, without saying to them that they do not know what their inflation rate is because I think most of them would say they do.
Professor Bean: You are absolutely right. That is a good subject for a speech at some juncture.

Q29 Ms Keeble: Which do you think is the biggest risk to inflation? You set out a number of factors in your memorandum so which do you think is the biggest risk?
Professor Bean: There are really two potential upside risks to inflation if we unpack the upside risk. One is simply that the underlying shock, the rise in global commodity prices, actually continues. Instead of the oil price levelling off, one cannot discount the possibility that oil prices may continue to rise for a while, though I think in the longer term there are good arguments for expecting them to fall back simply because the alternative sources of supply, like oil sands and so forth, essentially provide what ought to be a long-run ceiling. Part of the reason the oil price has risen so much recently is that those extra sources of supply have not come on stream as rapidly as one would hope. It is perfectly reasonable to expect that if the demand for oil continues to rise in the way it has done over the past few years, then the oil price may continue to rise over the next year or two. The second particular risk, and this is one that worries me personally—although it may be a relatively unlikely event, it would be particularly unfortunate if it happened—is if households and businesses start losing faith in the idea that inflation will stay low and around about the target and they instead start building it into their pay and prices, so that inflation becomes much more embedded into the system.

Q30 Nick Ainger: You said that basically it was almost inevitable that oil prices would continue to rise because of the imbalance between supply and demand and then they would level out. We are going to take evidence shortly on this issue and I think you will be surprised at the evidence which indicates there is is not a problem in supply and demand. The oil industry will tell you that as will the producers in the Middle East. If, as some have predicted, the market were properly regulated and the oil price could fall by up to 50% to $70 a barrel in 30 days, would you have concerns about the 71% of futures which is owned at the moment by investment banks, pension funds and hedge funds. We could actually create another global credit crunch because of the damage that they would do to themselves because of their overexposure. Is that a real risk?
Professor Bean: Can I, on the first part of your question, simply clarify? I was not saying prices would continue to rise and then flatten off. I think there are good reasons in the long term for prices to settle lower than they are now but it may take us a while to get there and we may have a period where they continue to rise and then come back down. That is consistent with what you are hearing from the oil executives and other oil experts. There are differences of view within the oil industry, though, about how quickly this adjustment might happen. As it happens, I have just come back from a major conference in Canada with both market participants and lots of oil executives present and there was a lot of disagreement about the short run prospect but quite a lot of agreement about the longer term outlook. The second part of your question is certainly a relevant issue. For some institutions, it could generate a not insignificant financial loss and worsen their balance sheets. And like all asset price corrections, that may have macroeconomic implications.
Chairman: Can we thank you for your evidence today and wish you every success in your new post particularly in these challenging turbulent times. We will see you again quite soon.

Treasury Committee Questionnaire: Response from Charlie Bean

Responsibilities as Deputy Governor

1. *Please explain how your experience to date has equipped you to fulfil your responsibilities as Deputy Governor for Monetary Policy. In particular, in what areas of the Bank's work do you believe you will be able to make an immediate contribution and which areas will you have to undertake additional research when in post?*

I have spent the past eight years both as a member of the Monetary Policy Committee and as the Bank's Chief Economist and Executive Director for Monetary Analysis and Statistics, the Bank directorate that supports the MPC. Prior to that, I spent 18 years as an academic at the London School of Economics, where much of my research was related to monetary policy and macroeconomics more generally. During that time, I also acted as a policy adviser to various bodies, including the Treasury and to this Committee. So I believe that my past experience leaves me well equipped for this post, and across the full range of responsibilities.

2. *To what extent will you require a different approach as Deputy Governor from that required in your previous positions, with regard to the discharge of the duties and responsibilities involved?*

As Executive Director for Monetary Analysis and Statistics, I carried the responsibility for day-to-day management of the Bank's activities supporting the Monetary Policy Committee, including the preparation of the Inflation Report and the projections contained therein. Those activities absorbed a considerable fraction of my time. My new role is more strategic in nature, and covers both the Monetary Analysis and Statistics, and Markets directorates. In my new role, I expect to have more time to devote to advancing the Bank's communications agenda, both on monetary policy and market operations. I also expect to participate in more international meetings than is the case in my present role. Finally, I expect to play a greater role in the Bank's management, including on financial stability issues.

3. *Do you intend to serve out the full term for which you are appointed?*

Yes.

4. *What are your major objectives in the first six months of your Deputy Governorship?*

There is no doubt that the UK economy presently faces the most challenging set of circumstances since at least the early 1990s and possibly earlier. We are faced with two substantial shocks of unknown impact and duration: the de-leveraging that is underway in financial markets and the associated tightening in the availability of credit; and the relentless rise in oil and other commodity prices. Both these shocks depress activity, but have conflicting effects on inflation. Meeting the Chancellor's inflation target, whilst simultaneously avoiding undue volatility in output, will be no easy task. So ensuring that the MPC gets the best possible analysis and intelligence from both the Monetary Analysis and Statistics, and Markets directorates, will be my number one objective. Ensuring that our aims and strategy in dealing with the challenge is well understood—not only by Parliament, market participants and the media, but also by the broader public—will also take a high priority.

Away from monetary policy, I expect that much of the energies of the Bank's senior management will be directed to preparing for and implementing the Government's planned changes in the financial regulation and stability arena.

5. *How do you intend to develop the monetary policy area of the Bank over the next five years?*

I am broadly content with the shape of the Monetary Analysis and Statistics Directorate, though it will no doubt continue to evolve over the coming years. In particular, I will expect my nominated successor as Chief Economist, Spencer Dale, to continue to press ahead with the "leaner but smarter" strategy we have been pursuing over the past couple of years. The Markets Directorate is still building its intelligence capability and there is a review presently under way of our market operations to identify necessary changes in the light of the experience of the past year.

6. *As Chief Economist, you were more involved with Monetary Analysis than the Markets side of your new brief. How do you intend to familiarise yourself fully with this latter element of your new responsibilities?*

The events of the past 12 months have meant that I have already had to come to grips in some detail with what has been happening in financial markets in order to assess their implications for monetary policy. In addition, I am a member of the Bank's Financial Stability Board and participate in the drafting of the Financial Stability Report. I am also a member of the group reviewing the Bank's money market operations framework. So I feel that I am already in a fairly good position. Nevertheless, I recognize that I will need to learn more and expect to spend some of my first few months in the post familiarising myself with more material, both internal and external. I also intend extending my circle of personal contacts to include more external market participants.

Responsibilities as Member of the MFC

7. *What contributions have you made individually to the conduct of monetary policy on the MPC? What lessons have you learned from your period as a member of the MPC?*

I would single out two primary contributions. First, ensuring that Monetary Analysis provides the MPC with high quality and timely analysis of the conjunctural issues facing them, together with delivering the quarterly *Inflation Report*. The annual survey of MPC members, carried out for Court, suggests that they generally rate the quality of the support very highly. Second, leading the economic discussion on the Wednesday afternoon part of the MPC meeting itself. In addition, I hope my speeches (eg on asset prices and monetary policy) have added to the public debate and understanding.

As far as lessons go, it would take a book to cover everything that I have learnt about the economy and about the making of monetary policy since joining the Committee. I have become acutely aware of the difficulties of extracting the signal from what are often conflicting indicators. I have been impressed by the value of the intelligence gained through the Agency network. From an economic perspective, I have learnt much from both the staff and my colleagues on the Committee about the wide variety of economic questions that have faced us. And from a policy-making perspective, I would highlight the value of a robust yet open-minded debate, where each MPC member brings something different to the discussion.

8. *What contributions have you made to explaining the work of the MPC and enhancing public confidence in its actions over the last three years? What activities do you intend undertaking in order to add to the public's understanding of the role and decisions of the MPC?*

Aside from my appearances before the Treasury Committee, since June 2005 I have made:

- 13 regional visits through our Agency network;
- 10 presentations of the Inflation Report (generally to business audiences);
- 21 presentations on what the MPC does (to a variety of audiences);
- 7 public speeches on a variety of economic issues; and
- participated in 12 Inflation Report press conferences.

In addition, as Chief Economist, I have had responsibility for overseeing the preparation of the *Inflation Report* each quarter, including the drafting of the Overview, as well as for the preparation of other public documents (such as the Bank's submission to the Treasury Committee's "MPC Ten Years On" enquiry).

Macroeconomics

9. *Over the next three years, what are the major risks you foresee to the MPC meeting the inflation target?*

The Committee is presently confronted with two major conflicting risks. On the downside, the dislocation in financial markets probably has further to run, especially if a slowing economy here and abroad generates a second round of write-downs, this time associated with corporate loans. Moreover, the impact of the tightening in the terms of availability of credit could prove greater than is embodied in the central case in our most recent set of projections. That might be so, for instance, if falling house prices have a greater depressing effect on household spending than we currently anticipate. In that case, the slowdown in growth could be even more pronounced and/or be more persistent, leading inflation to undershoot the target in the medium term.

The second risk relates to the prospects for commodity prices, especially oil, and the possibility that the current period of elevated inflation will lead to inflation expectations becoming dislodged and the higher inflation becoming embedded in the economy. Oil prices have systematically surprised to the upside over the past four years, reflecting the combined influence of sustained growth in global oil demand coupled with unresponsive oil supply. Though the price may fall back in the long run as higher prices generate substitution away from oil and new sources of supply come on stream, the near-term prospect for oil prices (and energy prices more generally) remains particularly uncertain.

As regards the possibility that the current above-target inflation will become embedded through second-round effects onto other prices and pay, we are already seeing more pass-through of higher costs into output prices than had been the case during the first phase of the rise in commodity prices. And while pay growth has so far remained subdued in the face of higher consumer price inflation, there remains the risk that employees will seek to maintain their living standards by seeking higher wages. Past experience suggests that it can be very costly in terms of foregone output and higher unemployment to reduce inflation, once it has become embedded at a high rate.

10. *How important do you think the official measures of inflation are in the wage-setting process in the United Kingdom?*

RPI rather than CPI remains the dominant reference index in pay discussions, particularly in the private sector. However, empirical studies suggest that the link from RPI outturns to wage settlements and earnings is much weaker now than it was in the 1970s and 80s. This probably reflects: changes in the structure of wage-bargaining; increased competitive pressures in product markets; increased availability of migrant labour; and the increased scope for offshoring production. All four developments mean that employees may struggle to obtain compensation for past and prospective increases in RPI, even though they may request it. Instead, the dominant criteria may be the ability of businesses to pay higher wages and their need to recruit and retain suitable staff. That may help to explain why pay growth has remained subdued, in spite of the pickup in inflation.

Printed in the United Kingdom by The Stationery Office Limited
7/2008 405172 19585