Telephone call between Prof. Sir Charles (Charlie) Bean, former deputy governor of the Bank of England, and David Marsh, OMFIF chairman, 19 March 2020

David Marsh: I am speaking to Charlie Bean, who was the deputy governor of the Bank of England the last time we had a really big crisis back in 2008-09, an active professor at the London School of Economics, and also part of the Office for Budget Responsibility, which keeps a watch on the British government's finances. What distinguishes this crisis from the last one that you had to deal with when you were at the Bank of England?

Charlie Bean: The nature of the shock is a very different one. The financial crisis took place after a build-up of financial imbalances, accumulation of debt and fragilities in the financial system with many financial institutions having overleveraged balance sheets. It took quite a while to unfold. It started in mid-2007 and we had periodic institution failures, and then the collapse of Lehman Bros in September 2008, which precipitated the near seizure of financial markets and the subsequent great recession from which it has taken a long time to recover.

DM: What about the underlying structures?

CB: This crisis is very different because it doesn't reflect a fundamental underlying problem in the UK or any other economy. It's an exogenous event, an act of God, or maybe we should call it an act of chance, in the form of the coronavirus. The necessary response to the health crisis involves enforcing limited interaction between individuals, encouraging people to work at home. This leads to very significant economic disruption. In principle, it should be a relatively short but very sharp shock. Quite how short will be linked to how long it takes to get a vaccine ready or appropriate antiviral drugs. But there isn't the same underlying structural problem in any economies which needs to be corrected.

DM: On the other hand, lots of central bankers including Mark Carney, the departing governor of the Bank of England, have made quite clear that we don't have much of ammunition left to combat crises of any sort, whether endogenous or exogenous. And we're not in a good position to fight what is now also partly likely to become a financial crisis as well as an economic one.

CB: That is certainly true. But it's worth remembering that the object of policy has to be to establish a bridge across this period where activity is depressed because of this sharp shock to supply and demand. And the key thing is making sure that this hiatus doesn't lead to permanent scarring on the economy and adverse effects on the supply side. You don't want perfectly viable businesses going into bankruptcy with lots of workers losing their jobs. it's a rather different task from the great recession where one was trying to boost aggregate demand to get consumers and businesses spending. Then we were running out of conventional weaponry and having to resort to things like quantitative easing and so forth. At the current juncture, I don't think things like rate cuts and conventional QE are the key policy weapons, because this is not about trying to stimulate aggregate demand. It's about providing this bridge and ensuring that the financial markets continue to operate efficiently. Of all the initiatives that were taken alongside [last week's] budget, I would highlight the term funding scheme for small or medium size enterprises, similar to the lending scheme we introduced back in 2012, and reducing the counter-cyclical buffers, which gives banks more capacity to lend. Additionally, the latest measures for the Bank to purchase unlimited quantities of commercial paper to help companies directly.

DM: The Bank of England and the government haven't yet resumed what you might call conventional quantitative easing, the wholesale purchases of government bonds. That might seem like the next step - there's going to be a huge amount of issuance by the Treasury. The borrowing targets have been put aside for the time being. So the Bank of England buying these bonds on the secondary market would surely be helpful from an interest rate point of view.

CB: We will have to see how much extra borrowing there is. When the chancellor announced the £350bn package [in last week's budget], £330bn of that is guarantees. If the loans are all repaid eventually, then that doesn't involve any more actual borrowing.

DM: There's been a lot of support for smaller companies.

CB: If this is quite a long period, possibly up to 18 months, the risk is you are financing the bridge through loans. The businesses when they come out the other side are so heavily indebted, they can't really operate as normal. There is a risk that you will have generated zombie businesses.

DM: A decade ago, we did see a lot of international coordination with the Bank of England and the Fed and the European Central Bank acting in concert. And then there was the G20 with a big fiscal response, incluing from China. This time it's everybody doing their own thing. Wouldn't it be better if everybody applied this bazooka in a coordinated way?

CB: The Bank's measures were coordinated with the Treasury. So there was joined-up action internally which was important. Internationally, you are absolutely right that there is less spirit of co-operation than we saw in 2007-09. We see more liquidity support and credit easing operations rather than conventional monetary policy, and this needs to be tailored to individual countries, since financial market structures are different in the US from the euro area and in turn from the UK. So, in the US, quite reasonably, the Fed has started reactivating special bespoke facilities that it developed during the financial crisis, because you have a much more diverse capital markets set-up in the US than in Europe.

DM: We have seen this run into the dollar and there's likely to be a big dollar squeeze. The UK has one government and one central bank. In Europe's monetary union, there are 19 different governments and one central bank. So would think that Britain would benefit from a more joined up response. Why is it that sterling has fallen so much, particularly in the last couple of days, now at a 35 year low against the dollar. That might be understandable because money tends to flow into the dollar at times of stress, but sterling has also fallen against the euro. So why is that?

CB: Sometimes size may work to your advantage, in terms of safe havens. I suspect that the past three years since the Brexit vote, the dysfunctional nature of British politics during that period and uncertainties over the final trade deal may be in the back of investor's minds. The UK has been running a pretty substantial current account deficit, around 4% of GDP, for some time. And with a bad outcome to the trade negotiations coupled with coronavirus, you could understand why some investors start thinking that the UK might not be a safe place to keep money.

DM: Your old colleague Andrew Bailey has just started as governor of the Bank of England. How will he stand up to this unprecedented initiation ceremony?

CB: It has been a baptism of fire, but the great virtue of Andrew - and I was very glad that he was eventually appointed to the role – is that he knows this territory like the back of his hand.

DM: The government chose somebody who is an absolute expert, not a word that the government sometimes likes to use. He does remind me a bit of 'steady' Eddie [George], with whom you worked when he was governor.

CB: Andrew's a safe pair of hands and he also knows the territory. It's tempting for chancellors to appoint somebody who will turn heads at international meetings or is deemed to have the right leanings on Brexit or whatever. But there are the most important thing is that you have somebody who has the knowledge and skills necessary to run a central bank, particularly if you come into the midst of a crisis I feel very much more comfortable with him in charge than any of the other names that were being bandied about.

DM: You are going about your life relatively as normal. You're talking to me from the London School of Economics. You are even going to give a lecture later today, although you're not quite sure how many students will turn up. How long do you think this crisis will go on for? It's a health crisis. Difficult to apply an economist's brain to this. What does your gut feeling tell you? Will it be a short, sharp shock or will it be with us for a very long time?

CB: Gut feelings are not the key issue. The medical side will determine how long it goes on for. Most people seem to think the incidence of cases should start dying away, after maybe another month or so, pretty much the same trajectory as we've seen in China. As you get into the summer, the virus is expected to be less durable. It will then come back again in the autumn. There'll be more people who might've developed immunity, but older people and people with health conditions will be vulnerable. And if there isn't a vaccine and there aren't effective antivirals by that point, we may be back with similar sorts of restrictions.

DM: But we may have a vaccine…

CB: The health service will have more ventilators, more beds, all that sort of thing. So we may be in a better position to, to weather it. The key thing from an economic policy perspective is making sure that, as soon as the health crisis goes away, the economy can bounce back to where it was and start functioning. And it's almost like putting an economy in deep freeze for a while. We don't want to have lots of corporate failures, unemployment has rocketed, and it would take a much more of an effort to get the economy restarted. That's when the demand management policies would potentially be important as opposed to the more surgical interventions being taken at the moment by the Bank of England and the Treasury.

DM: So once the surgical side has gone away from the medical point of view, it'll be time for surgically administered demand-management policies. In the meantime, I hope your lecture goes well. Charlie Bean, many thanks for your views.