Central bank independence in an era of financial instability

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Event: OMFIF discussion on central bank independence and financial instability

Speakers:

• David Marsh — Chairman, OMFIF

• Andrew Bailey — Governor, Bank of England

Context: The discussion considers operational independence, supply shocks, monetary and financial stability, political scrutiny, the balance sheet, accountability and the effect of technological change. The discussion took place during the Bank of England's pre-meeting quiet period, so Bailey did not comment on forthcoming monetary policy decisions.

Why is central bank independence under renewed scrutiny?

DM [00:30]: This is David Marsh from OMFIF. Andrew Bailey, governor of the Bank of England, joins us to discuss a rather fraught subject, close to everybody's hearts, the question of central bank independence in an era of financial instability. And this has been quite a bit in the news, not just in the UK, just to set the scene slightly before the governor makes a few comments, and then we'll go into a Q&A session. We've got a new Treasury Select Committee report coming out sometime in the months ahead. It's just started in September. We've had several reports also from the House of Lords Economic Affairs Committee. We've had the Ben Bernanke report into what happened over this 'transitory inflation' and whether the Bank could have done better two or three years ago. In other countries, in the US, there has been a debate about how independent the Fed is from political influence. We've had various central bankers deposed. The most notable in Indonesia. So all these things are reverberating around the world, and we look at the European Central Bank as well, which has got on paper the best degree of independence, where it might get drawn into a political fray. I stress the word 'might' over the issues of what's going on in France right now. So it's a hot topic. So Andrew, you're getting ready to discuss all these issues. Perhaps you could just give us a few opening remarks from your point of view. We're not going to be talking about current monetary policy because we have entered rather early the quiet period ahead of your next meeting in early November. Looking forward very much to what you have to say, Andrew. And then we'll have a question and answer session with myself, joined by members of the audience.

How do repeated supply shocks test independent monetary policy?

AB [05:56]: And as you say, it's a very good subject. It's always a very good subject to discuss. A particular timeliness to it. First, let me say quite straightforwardly, I very much welcome the TSC work that they're doing. I think it's an excellent thing because it's such an important subject, and a very important part of our accountability. And I'll come back to accountability in a few things I'm going to say at the beginning. The sequence of things I'll say naturally leads to accountability. So I think there are there are a number of challenges in the current environment, which put this question of independence into quite sharp relief.

The first one I'll start with is the monetary policy world, but as you said, we're in the quiet period, so nothing I say should be taken as in any sense giving you a clue as to how we're going to make a decision in just over two weeks' time because we're not there yet. So these are more general points, longer run points. We've been experiencing, and are experiencing at the moment, what I would call a sequence of negative supply shocks. Effectively, the Gulf conflict is the latest of those. You can also point to Ukraine. We can debate COVID. I tend to think it was both a supply and a demand shock. Supply shocks and negative supply shocks are hard to deal with because they create this trade-off potentially, often actually between inflation and activity.

Now it's not as if central bank mandates can't handle it, but they are more challenging. There's no question about that. I think that they do, however, emphasise the need for central bank independence and the need for monetary policy frameworks and monetary policy targets. I am not asking for you to show me any pity, but these are harder times to deal with and it's it's at times like these that we need the frameworks. But I recognise that it's also at times like these that there can be more questions raised about how independence works, how accountability works.

The second point is dealing with negative supply shocks that come in close sequence, close succession. There is a standard view that, if you if you face a single supply shock, a single negative supply shock, you should essentially look through it on the basis that the market transmission mechanism will typically often be longer than the supply shock. That is the origin of the point about COVID. The problem is that we had a second one, a very big one, in the context of the Ukraine conflict, and you can't make the same points about the transitory nature when you have a sequence of shocks , because they clearly go on for longer, and that is much more challenging. It's also much more challenging in terms of what impact they leave in terms of public expectations, because if the result is that inflation is higher for longer and has been that result, you know we have to deal with it. But of course, it does leave an impact, and we have to assess that very carefully.

So, a period of supply shocks of this sort is challenging, but it's also a period when we need institutional structures more than ever. That's the first point. Second point really is about the balance sheet and about conditions. One of the questions that remains to be debated again and again is what are the tools available when you get to the lower bound.

What happens when conventional monetary policy reaches its limits?

AB [09:44]: I'm not going to enter into the debate about where the lower bound is. Let's assume you are at the lower bound. So lower bound of interest rates, or normal interest rates. There are possibly three tools you could use. You can use quantitative easing. You can use negative interest rates. You can use fiscal policy. None of those are, I would put forward, outstandingly attractive tools. They're not tools that one sort of reaches for with great alacrity. Let me put it that way. But you know, the question is, what do you do? And I think we have to come back to the whole debate around quantitative easing. I think we do have to come back to that question because that question lies at the heart of it, and it's a sensible question to come back to.

Those tools are more challenging in the context of the independence of a central bank, because they are not normal tools. They have impacts, and the transmission mechanism is more complicated as well.

The third point I come onto is the financial stability point. Central bank independence is often construed in terms of monetary policy, much or nearly all the literature depends on the academic world is in the context of monetary policy. And I gave a speech at Columbia University back in April on this subject, and I used it deliberately to expose one of things that gets talked about a lot in

private, but doesn't get said much in public: that we have independence in respect of financial stability. It's well defined in legislation. It's got accountability attached to it.

It's got institutional structure attached to it, but the two things are not the same.

In my experience, independence in respect of monetary policy is a very different animal to independence in respect of financial policy, and I use the speech of Columbia to go through why that is and what are the consequences. I'll give you a practical example. Over nearly 30 years of the MPC's existence, I've been involved in most of that period in various roles in the Bank of England. I can think of only a very small number of occasions on which serving ministers have questioned MPC decisions, have sought to influence MPC decisions, and it has been, I think, a success. That is by no means the case for financial stability, and I don't say that to criticise. I make this as an observation. You can read it in newspapers many days.

Why is that? I tried to set some of this out in the Columbia lecture. The policy reach of financial stability is much larger in many ways. It's not because monetary policy is narrow; it has very big impacts, but it is quite contained as a policy. Financial stability touches on a lot of areas, a lot of other areas of public policy – areas of growth, even areas like environmental policy. There are a lot of touch points. Second, it's not the case that monetary policy does not engage interest groups in the economy, but it doesn't engage them in quite as pointed a way as financial stability does, because financial stability directly impacts institutions like, for instance, banks. All the literature tells you that they will lobby as a consequence of that, and indeed they do.

Now, it's not that we don't get lobbied on monetary policy, but I would I would say, from long experience, the nature of the activity is very different.

Why is independence in financial stability more complicated?

AB [13:55]: So financial stability is different. I don't think there's any point bewailing this and saying: 'Isn't this terrible?' But I do think it's important to be much more open about it, and it shouldn't be a hidden secret, because in many ways it's staring at us in plain sight. But I think it is something that should have more discussion. And you know, if I had one point to make about the TSC enquiry, is it is all about monetary policy. Now I know why I understand exactly why they're doing it, but there are some very important issues on the other side of the house. So that brings me finally back to accountability. It's very important that we define independence quite carefully here. It's a very carefully constructed form of statutory provision.

We are independent, in effect, of government. We're not independent of parliament in the sense that parliament can legislate. And we're not independent of the people of the country. Of course, we're not. Nobody ever should ever think that we are, nor should we be. We serve the people of the country. We serve their representatives and parliament. We're accountable. To them, I take that very seriously. I think this is how democracies work. It is a very well structured form of independence. It must be, otherwise we really lose our legitimacy. An important part of that is accountability. Accountability to parliament, accountability to the public, accountability to the public through parliament. I have appeared in parliament more times than I care to remember. I regard it as among the most important things I do. We take it extremely seriously, and I know my fellow governors in other countries do as well.

It's very important, and I therefore welcome the report and review that the TSC has just announced because I think it's a very important part of our accountability, and they will get a very serious input from us at the Bank of England because we welcome it, we take it seriously, and regard it as an important part of the institutional structure. So, David, I'll leave it there, if that's okay.

How can the Bank remain credible when inflation is above target?

DM [16:01]: Thank you. We'll go through all those points one by one, and we'll also take up the QE point that you've invited us to look at. It's interesting that you are giving some advice to the TSC about possibly bringing in financial stability. I hope that they're listening as well, and maybe they'll add further to the burdens on you on this, making more work for yourself. But perhaps I could go back to first principles. Because we've had this period , over the last 25-30 years, we've had central banking independence, as you say, from governments and from policy-makers on the political side. We've had that now enshrined in a number of countries around the world. This has, of course, coincided with a period when we did have pretty low inflation, partly because of the entry of China into the World Trade Organization.

It makes it easier to defend central banking independence, which we know in Britain has been a hot topic for 100 years.It makes it easier to defend if you've got the evidence to back this up. However, what's gone wrong in the last couple of years is that central banks were slow, I believe, in putting up interest rates after we had the aftermath of COVID and then the opening of the full-scale invasion. And it's more difficult to defend at a time when inflation has been above target, not just in the UK but in other countries. In other words, do you feel, not just with parliamentary inquiries, but in your day to day life, that you need to go the extra mile to prove that this thing does work? Because the empirical evidence backed it up in the first 20 years. It didn't in the last three or four years.

AB [17:40]: It's a very good question, David. I don't want to be understood as being self-serving. The first period was a period of quite small shocks, frankly. And as you said, there was there was probably an impact from China joining the World Trade Organization, but there were also quite small shocks in the economy. That has not been the case from the financial crisis onwards. So you can divide the MPC's life into two somewhat slightly unequal halves now, because the second half is obviously getting longer as time goes by.

So that's the first point. Second one – and I'm not going to give any clues and any comment on what we're going to do in two weeks' time - let's look at where we are today. Let's go back to immediately before the conflict broke out in the Gulf and Middle East.

I said a number of times I was very much expecting us to be back at the 2% target in the late spring, and the question then for us was, what interest rate level would we set to hold it there? I have seen nothing subsequently, including today's number, to change my view on that. Unfortunately, with the conflict breakout, which has severely affected energy markets, much of our inflation is in energy prices. Now no central bank can create world peace. We can't predict, we can't forecast when these conflicts are going to start, and we can't solve them with monetary policy. In the sense that monetary policy doesn't bring peace in the Middle East, our job is to return inflation to target, and the test of the effectiveness of central bank independence and the monetary policy framework is how we do that.

In a sense central bank independence is more important in conditions like these than it is in the times in the past, for holding inflation at 2%. It's not because my predecessors had it easy; they were dealing and they were operating in very different circumstances. These are these are times when we need the institutional structure more than ever.

DM [19:57]: Would you say that at a time like this - when it's very difficult, you've got many different factors impinging upon you, things which you can't focus on entirely by monetary policy - that you're going to, as a creed, and as a cadre of central bankers, run the risk of being very unpopular. Are you willing to go through that valley of tears of unpopularity to do the right thing for the right reasons at a

time when the rest of the political scene and the public might find that this is the wrong thing to do. Are you willing to take that hit?

AB [20:33]: Yes to that question because otherwise we're not doing our job. You're right, and it's a very good question to pose. I think, and it's the right question, and the answer has to be yes.

How should the governor and chancellor work together?

DM [20:41]: And another question, which goes to the heart of the matter, before we come to the more technical details , is this issue about fiscal-monetary cooperation. Now, in a perfect world, you'd have the fiscal side doing their thing, and you'd have the monetary side doing their thing. You are monetarily independent. You've been given that by parliament in 1997-98. Is there not a time, particularly at a time of great crisis, when you do need to have some coming together of the fiscal and the monetary side? How you do that? I don't know whether that's through regular meetings with the Chancellor, which might happen anyway, or through some slightly more formal way of coordination between the Treasury and the Bank of England. Could that be done without undermining your independence in this very valuable area of setting interest rates? Should there be more monetary-fiscal policy coordination, not just in speeches, but in day-to-day solid practical decision-making.

AB [21:43]: Well, let me give you a sense of how it works, because I think the answer is a bit a bit nuanced . So first of all, the chancellor and I – by the way, I'm on the seventh chancellor ...

DM [22:00]: ... I was going to say, whoever the chancellor happens to be ...

AB [22:03]: .... actually, six since I started my term, since I was appointed ... the chancellor and I discuss the economy regularly, and I think that's right. I think most central bank governors do that - when I talk to my fellow governors - I think that's the norm. I don't think there are many cases where independence as interpreted as meaning you know you don't discuss the economy. We discuss the economy regularly, and we you know we exchange views on it. We exchange what we've learnt on the economy, and that's very important. What we don't do is say, well, if you do this, I'll do that. Just to put it quite simply, but what we obviously have got is that both policies are operating within frameworks. Monetary policy obviously has its target structure and target framework and operational framework.

Fiscal policy, in many countries, including the UK, not all, but in many countries, has a framework it's operating in. The UK is a good example of that. So the question – 'Do we need to, in a sense, coordinate more in the sense of making the policies interactive?' is really answered through the frameworks. We're both operating in our frameworks. When we have shocks like the one ones we're going through at the moment, we have to think hard about how do we work the framework in this context? You know, how do we put the framework to use? There's a very important line between saying: 'Are we operating within our frameworks?' and crossing the line and saying: 'Well, if you do this, I'll do that.' We're not deal-making in that sense. I'll never do that.

DM [23:47]: But do you think that there's a hidden assumption, which doesn't need to be spelt out , that if the fiscal policy side sticks to their lane and does things which you generally find to be helpful from a stability point of view, then you will be helpful too. You don't need really to spell that out because, as you say, that would be undermining your independence, if you did have a specific deal in mind. But should there not be almost an 'expert system' that links the brains of Threadneedle Street and the brains of the Treasury , so you know that , if you step out of line, you're going to get trouble from the other end of town. Is something like that in your mind?

AB [24:25]: First of all, we talk a lot about the economy. The second thing we do is that all our forecasts. I'll take it from our end: we condition our forecasts on announced fiscal policy. So our forecasts are conditioned on what the government has announced. So, in that sense, we're coordinating because we're saying: 'You tell us what you tell the country, what your fiscal policy is. We will then use that as the basis to form our views on the state of the economy, to form our views on the forecast looking forward for the economy.' Of course, that's not the only determinant of the decisions we take in monetary policy, by any means, but it's an important one.

What did the 2022 gilt-market turmoil reveal about central bank independence?

DM [25:07]: You've been around a long time, as you were saying. You've seen most of these 30 years of ups and downs. I do want to just ask you about one particular high or low point, which of course was in 2022, when we had an incoming prime minister who didn't like you or didn't like the way the Bank of England was going about things and did threaten to undermine you, maybe even to ask you to go. That didn't work. In fact, a gentleman at the other end of town went instead, and I think you don't have to be a Nobel Prize winner to work out why that was. How has that experience changed you, Andrew? I think myself, and you don't have to say this, it made you more or less unsackable. I think you were unsackable before. Probably it made you even more unsackable. How did that work? How does that affect you? Is it something which has somehow added to the philosophy that you might have, being an independent steward of monetary policy working from the Bank of England.

AB [26:08]: Well, first of all, as I understand it, Liz Truss is going to publish a book next week on this subject. I've not seen it. I've only just seen the blurb yesterday. So I don't know what's in it. I can probably imagine, but I don't know what's in it. I've never met Liz Truss. So I don't know her. I'm not going to comment on Liz Trust because I just don't know her. It was obviously a difficult period. I think, all round, it was quite a quite turbulent period, particularly for markets, and we had to respond to it, and we did. The interesting one of the big things I took from that period was that we faced a financial stability problem, and we dealt with it.

I think it was a very effective operation. People said, 'Well, should you have anticipated it?' It was well out in the tail of the distribution of possible outcomes, I always say you have to, in our world, have both what I would call regulatory tools, and also tools that operate in the tail beyond where regulation is cost-effective. In other words, you have to have tools of intervention. I think this was added to that territory. We created the tools of intervention, and we dealt with it. And so I think it was a successful operation.

DM [27:30]: Do you think, in retrospect, that in some ways you were quite fortunate because you did manage, I remember, to get the software sorted out for the index-linked gilts more or less over a weekend? And that did allow you to meet your deadline. It was a risk, wasn't it, setting that deadline to say we're just going to give the market participants that amount of time, and we've got to get our house in order in that time? Had that not worked, your job would have been quite difficult to hold on to. Was it luck or was it all just brilliant timing?

AB [27:59]: Well, let me say a few things on that, and I do want to come back to what we learned from that period. But let me say on that , there were two points . We set an original deadline when we started the operation, and then I made a subsequent comment about you've got three days left to complete it. Just to be clear, the three-day comment came after we had sorted out the index-linked issue.

DM [28:17]: Yes.

AB [28:18]: Let me also say on the index-linked issue, it was a game changer in terms of completing the operation. You know, the message we knew we knew how much needed to be done because we were in very close contact. I always say we had a lot of inside information. We were in very close contact ....

DM [28:34]: where your market intelligence department played a role, doesn't it?....

AB [28:37]: ... We knew exactly pretty much exactly what needed to be done. We'd never taken index-linked gilts in our operations. There was a sort of aversion to it. Some other central banks do. We didn't. It became clear to us that to finish this thing off successfully, we had to cross that cross that bridge, if you like, and we did. On the technical point about systems, I take my hat off to my fantastic people who work with me. I'm very lucky to have as colleagues who, yes, fixed it over the weekend. They did it, and it was successful.

DM [29:09]: I think you invited them all for a cup of tea afterwards, didn't you? To celebrate.

AB [29:14]: ... a cup of tea and a cake, actually ...

DM [29:17]: but to answer the original question: Has that made you stronger? 'That which does not kill you makes you stronger.' Would you agree with that?

AB [29:25]:. I want to come back to the point that we learned from that, and a lot of other central banks have talked to me subsequently about how they feel that the Bank created a very interesting and important initiative here. The thing that I was very concerned about, and why we had to set a time deadline, in good part was because - and we got some of this, you remember, from quite a few people who said: 'Well here you go, you're doing QE again' - and of course this was a point where we were raising interest rates ... '

DM [29:59]: ... It looked as if you were going against the grain, didn't it? So that was a communication problem ....

AB [30:05]: 'You're off to do QE because you people always do QE' - and I was very sensitive to that because we were not doing QE. It would have been crazy to do QE for market policy purposes at that moment in time, and so we had to distinguish what we were doing. Now I think what we learned from that was we were dealing with a financial stability problem. We need to have the tools to do both monetary policy interventions and financial stability interventions, and to be able to distinguish between the two very clearly.

And we learnt that. I don't think we had, before that period, scoped that out quite as much as we needed to, nor did other central banks. So out of that, that's the big lesson. You've got to have tools for financial stability interventions, and you've got to be able to distinguish them from monetary policy tools, from QE tools and to be convincing.

Now I think we managed to do that. A lot of people thought we wouldn't, and that we wouldn't end it.

How should quantitative easing and its costs be assessed?

DM [31:10]: That is why this is why I persist in thinking you were a bit lucky that you did manage. But, let's not go down that path any more. Something I just wanted to go into this issue that you were saying just now-if we did get to the zero bound again, there'd be these three tools. It was interesting. You mentioned fiscal policy, but you mentioned negative interest rates. You mentioned QE.

Do you think, with the experience you've had, also the difficulty of unwinding QE - you've recently announced that you're not going to be doing the so-called quantitative tightening in quite the same way - it's going to take longer, therefore, to unwind – and I know your term ends fairly soon, but for

any central bank governor in England, in Britain in the future - would you say that the road barriers or the psychological hurdles for doing more QE have got that much larger? Partly because we know it produces diminishing returns, but also because we know it's so damned difficult to get rid of this high balance sheet.

AB [32:10]: Well, I can tell you from personal experience, it's very easy to agree with you and end it there. But you may remember, we had a debate. This seems like ancient history now, but we had a debate in 2020 about negative interest rates. Of course, other central banks did it. I don't think it's an easy tool. I really don't. I was very, frankly, cautious about it at the time. I'm still cautious about it. I don't think that's at all easy as a tool. Its effectiveness also has to be called into question. There are real limits on how much you can do because of the alternatives, instruments that are available that avoid it.

And then look, I include fiscal policy not because it's obviously not for us, but because if you look at the textbooks, they will say to you, 'Well, those are the things you can do. None of them are attractive, frankly.' You know, I don't think any of us would say, 'Yeah, you know, there's one in there that's an obviously attractive tool.' There isn't.

DM [33:18]: Let's go into the famous issue of the indemnity. You've said in conversations with us in recent years, Andrew, that you would be in favour of the Treasury publishing the famous indemnity regarding losses made by the Bank of England. The House of Lords Committee asked twice for this. in 2021 and 2023. It took the Financial Times and the Freedom of Information Act to actually get this indemnity letter released, I don't think the world is that much the wiser for this. We're a little bit the wiser, but why did it take so long when you wanted it?

AB [33:51]: Well, let me be clear. Of course, the indemnity is owned by the Treasury, not by the Bank of England. I have put myself in that position, as I said to the House of Lords Committee just to reassure them. I'd obviously read it carefully, and I was worried that there was a degree of sort of conspiracy theory around this indemnity. I'm afraid, that when you read it, it wasn't a particularly exciting document. It wasn't intended to be a particularly exciting. It was never intended that way. It's a pretty dry document. It's not for me to talk on behalf of the Treasury . From a Bank of England's point of view, our point of view was: look, we do not want conspiracy theories. There's enough stuff going on without having a conspiracy theory around the indemnity. But it was the Treasury's decision, because they have to look more broadly across the whole of government.

DM [34:38]: In terms of the effect of what you've announced recently on the balance sheet: you obviously want to move as quickly as you can to a more narrow balance sheet structure, and you want to make this demand-driven. You don't want to have per se a high balance sheet going into the future history. Also, very interestingly, you're going to be now selling back to the market a smaller amount of these gilts, but you're still going to be doing it. You're going to be doing it directly through the Debt Management Office, rather than onto the onto the market. The obvious question goes back to my question about interaction with the Treasury. Does this in any way undermine your independence, to the extent that you have to be talking to a very substantial arm of the Treasury on an important issue like this. How do you see this affecting you?

AB [35:31]: Very firmly not. This may be because I'm sort of a practical person, but let me explain my thinking there. So we've laid out the amounts that we will do per annum for the remainder of the time needed to get down to ... basically where we're only left with the stuff that's back in the note issue, and we reckon once you take the natural maturities into account, that's £20 billion a year. So, first of all, it's very important that we pre-commit to that number. So that takes that off the table.

Then is there going to be some negotiation about how much? It then becomes what is a fairly mechanical issue about what is the most cost-effective way to deal with that £20 billion a year. Now, the issue is a practical issue: that , as we go through the sales, the stock that we are left with is increasingly comprised of off-the-run gilts. You might say there's a sort of residue, and the cost effectiveness of selling off-the-run gilts is obviously a question. You know, we have to have this in mind because the government quite rightly says, you've got to do this for monetary policy purposes, but you've also got to achieve value for money. So I think it is. I think it is most cost-effective, from a value for money point of view, to say - and we're still in discussions on this, so it's not finally settled - it is more cost effective to sell them to the DMO, and the DMO can then repackage them and sell them as on-the-run gilts. We can't do that in the Bank of England.

DM [37:14]: ... and when you say cost effective, you're talking really about the loss to the Exchequer, the money coming out of the Exchequer to pay you , would be even higher...

AB [37:22]: ... the cash flow, cash flow attached to them. Yeah ....

How should financial stability powers be held accountable?

DM [37:26]: Well, it will be really interesting to look at how this works. I can see your point totally. Now I've got quite a few questions from the audience. I'm just going to read them out without saying who's put them. One really apposite question goes back to what you were saying before . about the need for accountability. The person from the audience says, 'Is it the case that, because you have taken on macroprudential policy and banking supervision, you are in a way exposing a greater degree of your flank?' The person in the audience says, "It triples the attack surface now.' I know that's not been your decision, but is that how you see things as well?

AB [38:07]: Well, obviously, it's wider. It's a wider scope of public policy. So, in a very literal sense, that point, the answer is, of course, is Yes. But I would take you back to the financial crisis, and it's the consequences out of which these changes come. And I was quite centrally involved in the Bank's work during the crisis. I'm afraid that the arrangements that were put in place - going back 30 years now, which took took regular bank supervision out of the Bank - did not set up an effective financial stability framework in the sense that we have it now. It left us very badly exposed in the context of the financial crisis.

I dealt with a lot of these operations . We had to come to terms with what we were dealing with. We were, literally, in terms of bank balance sheets, working from a standing start, as it were, and I don't think that's a good place to be. And I think we were very exposed collectively, you know, as a country on the financial stability front. So for me, the benefits of having these things together in the central bank and being able to, in a sense, fit them together, because the pieces do have to fit together. substantially outweighs this sort of exposing more flank points.

How do central banks coordinate without falling into groupthink?

DM [39:27]: I can see that point. Another question from the audience goes back to this issue about the supply shocks and how many of them are coming along. And I think I'd bring this also into this issue about groupthink. This has come up from time to time, also in various reports, including the House of Lords report. The question says: 'How do you coordinate with other central banks, e.g. through your leadership of the FSB, to address the consequences of the supply shocks?' Do you find yourself just going around in circles where everybody more or less agrees, saying 'Isn't it terrible? But we're trying to do the right thing.' Or do you find that other central banks come up with some really sharp focus points that help you to go down in a better direction?

AB [40:08]: Obviously central banks talk a lot to one another. I'm borrowing a phrase Eddie George used to say: I think I sometimes see more of my fellow governors than I do of my family some weeks. But we do talk a lot, and I think that's very important. I mean, there's a reason why we end up in Basel so much, and of course have done for pretty much 100 years. It's very important, and I think that the institutional bond among central banks is very strong. And I think actually, interestingly, it isn't there in other areas of public policy. I think it is very important. We were in Bangkok last week, so you know, we've seen a lot of each other.

DM [40:47]: I know, but that's not really the point, Andrew, because there is a kind of wagon train mentality. I think, particularly when central banks can be under fire, as they have been in the US, they kind of band together. It's almost like a trade union . They say , 'We're all in this together'. For instance, Jerome Powell is getting a huge amount of support now. I think he did make some mistakes earlier on in his career, but because he's been so much under attack, everybody puts the wagon train around him. I'm wondering whether that sometimes can hinder rather than help the constructive exchanges of views, because you tend to agree with each other, partly because you're under attack.

AB [41:23]: I'll talk to you about the Jay Powell context. The point at which, as other governors, we decided to go public on this, in our view, was when it became an attack on him as a person. Not because of what I would say is Fed policy. I know him very well. We know each other as I know other governors very well. I count Jay as a friend. I know Kevin Warsh very well , as well, but I count Jay as a friend. He's a man of the utmost integrity. I think it was the right reaction in that time to say, 'I'm sorry, we are going to stand by our friend.' I would do the same again, frankly.

DM [42:11]: The irony of it, from the point of view of the president of the US, is that Mr Powell, for reasons which only he knows, has elected to stay on- first time for 75 years that the departing chair stays on the board , he's got a right to do that, and so arguably, from an outside point of view, the Fed has now become more hawkish, shall we say, or more likely to stick to a firm monetary policy than it might have done, had he gone in the normal order of things. So would you like to comment on what seems to be a historical irony?

AB [42:38]: Because that's a matter for him and for the Federal Reserve, not for me, not at all. I only commented when I felt it was an attack on his person and the personality of a friend. I wouldn't dream of intervening in another central bank's policy area. But we do talk a lot because we talk about the world economy a lot. We talk. I mean, look, we've spent a lot of time talking about the impact of events in the Gulf because that's you know that's where we get shared wisdom as it were. Does it cross over into groupthink? Well, we are each operating under somewhat different, slightly different mandates. We each have to go and take our decisions for our economies. I've been very clear, and I remain very clear that, when you look at the MPC, any accusation there is groupthink on the MPC, I'm afraid, falls at the first hurdle, in my view.

How should fiscal choices and inflation shape monetary policy?

DM [43:34]: I think you do tick the boxes for diversity on both committees that play a substantial role. I think you can certainly say that you have plenty of diverse people there. Could I just raise a point that came out of the IMF. The IMF has said that the government should target cost of living support to poorer households. Now this really does come into this issue you were making about the financial stability side of things, where you are actually entering into the political domain. I mean, if that were to be the case, if the government were to do cost of living support for poorer households, would this help or hinder the Bank of England's inflation fight?

AB [44:15]: As I said before, whatever the government decides to do, we will take it into account because we always factor in policies that the governments announce, and that's why we would do it. It's not for us to stand in judgement on other areas of public policy. I think that is a independence goes both ways. This is the important thing. You know, I'm very clear that I don't expect government to intervene in the decisions we take. But equally, I think government can very rightly expect me not to intervene in other areas of public policy, that's right. Now, to your point, I think the point you make you made though is very important, and it goes back to my introductory remarks. Financial stability is more complicated. It does overlap and it comes into contact with many other areas of public policy. So we talk to government about this.

So I'll give you an example at the moment. We are talking very actively to government about AI because we've got a very strong financial stability interest in AI. They've obviously got many interests in AI from a public policy point of view. It's natural we should talk about them.

DM [45:19]: I'm sure there'll be a lot of that coming up in all these reports. Something goes back to the question I put earlier, but maybe in a sharper form, from the audience. It's a very simple question: Are you concerned that having inflation persistently above target could undermine BOE independence? In other words, are you going to be even more robust, even more steely in what you do in the next few months than you might have been had you not had that experience over 'transitory'?

AB [45:50]: Well, I'm concerned about inflation being above target. Let's be very clear, and our job is to bring it back to target. Let's be very clear on that. There's no ambiguity whatsoever. What the what the UK legislation says. In this context is what we tend to call the trade-off language, which was put in there about 13 years ago. So we don't have a dual mandate, and I think that there's a good reason for that.

I've never been a great fan of dual mandates because I don't think the mandates ever really explain how the pieces fit together, but I think the trade-off language is actually helpful. It's another, alternative way of getting at this question because what the trade-off language tells us is, you know, it is our job to return inflation to target in the event of this type of negative supply shock, and we also exercise judgement over the period of time that we think it is appropriate to return inflation to target, and we will do that.

Now you're right, David, that, as you said to me, what are all the things you have to consider in reaching the judgement on that question of what's the appropriate trajectory back to target? The incidence of previous shocks and their impact on inflation, obviously, is something we have to take into consideration in that respect.

DM [47:07]: You remember when Jean-Claude Trichet left the European Central Bank in 2011? He was so proud to say : 'We've achieved price stability of 1.99%.' He actually slightly overdid it. I think he made life more difficult for future generations of central bank governors. It's very likely, Andrew, if I may say so, that you will leave the governorship in 2028 with inflation still over target. I mean, nobody knows the answer. Does that does that make any difference to the way that the future historians will see you. Do you think?

AB [47:41]: Well, you have to deal with it. None of us gets to choose the circumstances and the context that come our way. You have to deal with what comes your way. I always slightly semi jokingly say, 'Mark Carney's got brilliant timing and I've got terrible timing.' And I don't say that with any envy. That's good luck to Mark. But you know, look, you have to deal with the situation as you find it.

DM [48:05]: You came in just at a time when QE was really being revved up, and in a sense, everybody else was doing it. So the Bank did as well, and that was, you might say, the last straw. But we won't go into that now. I've got another question now coming in, this might be slightly getting into current monetary policy grounds, but I think it's allowable even under the quiet period. This questioner, who's a German banker, says that you recently said that the central bank can look through an energy shock only while inflation expectations remain anchored. Yet by the time higher expectations are visible in wage and price decisions, that policy may be late. So the question is about second round effects. What combination of signals would make you act before the second round effects are clearly observable? You're asking you really to have a crystal ball, and what evidence do you see right now in the case of the UK?

AB [49:04]: I will try and tread very carefully around that. There are quite a few aspects of that question which touch on the current decision-making environment. Let me let me say this: If we were to wait, in any situation like this, if we were to wait for the sort of the picture of second round effects to be fully emerged - I'm not saying anything new here- it's most likely we would have waited too long. That's a fact because of the way in which the transmission mechanism works. And that to your to your point, David, is why expectations, inflation expectations, are important because obviously they're a forward view. Now they're only a partial forward view. Obviously, they're not the full view. They're not. They don't give you the full answer. But that's why we and other central banks do look at them carefully.

What role should financial markets play in central bank decisions?

DM [49:51]: I think it's probably about as far as you can go. I mean, at the moment, in many parts of the world, including the US, you don't see huge second round effects coming up straight away. You don't see it in Europe. You do, funnily enough, in Japan. Well, I just came back from Japan this morning. There you see wage rates going up by 5%. But that actually is part of the policy. People seem to be quite happy about that. So it is a very multifarious world. That leads me to a question about Mr. Warsh. He has been on record as saying we need to look at the financial markets around us. We need to perhaps take a bit of a hint from them. He's also said he said that at the IMF last week. We need to open the window and look at the world around us. That seems a slightly strange remark because, after all, as you said, Andrew, you do look at the world around you.

You look at the world as a whole, but do you think there's anything to be said in this idea that Mr Warsh did have, at least until a few weeks ago, that the central bank should be looking at the tightening of financial conditions going on around them? And if you like, let the markets be in the lead. Let them be the horse, and you can be the cart. Do you do you see anything in that? As you say, you know Mr Warsh quite well, so you might be able to understand what he's getting at there.

AB [51:04]: Well, I think you have to take. Let me divide that into two parts and then try and fit them together. You have to you have to take financial conditions into account, so you have to take market conditions into account. I mean, there are many ways of doing it. There are many people who constructed financial condition indexes, monetary condition indexes. It's a whole sort of genre of its own. I've given the example recently a number of times. When you look at the increase in mortgage rates across the G7 , since the conflict broke out in the Middle East, the UK has got among the largest, possibly the largest increase in mortgage rates across the G7. Even though we have not at the Bank of England raised the official rates - that's because we were expected to cut rates this year.

So we've tightened policy in that sense, because we've taken those cuts off, to the extent they were on the table. They're off the table. So you have to take that into consideration because that's real economy stuff. Mortgage rates affect people very directly. I would distinguish taking into account

markets, and the impact of markets, from the second leg of this, which is: Do you therefore just let the markets do the work? I don't think you can do that because I think ultimately we and markets are both responding to the same information. Then there's not an obvious leader in that in that process. So I don't think you can say it's fine, the markets will just sort of do it for us. I don't think that. That's not a good way to go.

How serious is the risk of fiscal or financial dominance?

DM [52:41]: Leading on from this, a question from Mark Sobel about fiscal or financial dominance. This, I think, this makes the present situation and the forthcoming central bank meetings, whether in October or December, even more important because there has been this spurt of comment about, basically, the tail of the fiscal side wagging the monetary policy dog, if you see what I mean. The fear is - Charles Goodhart has put this forward on many occasions - that if rates are going up at a time of high public debt, central banks might be more averse about raising their short-term interest rates because they may come under pressure from the governments to keep borrowing costs down. Do you think we're really getting into that situation where that might be a factor? Perhaps not for the Bank of England, but for other central banks? Or is it not, as François Villeroy de Galhau, the departing Banque de France governor, put it very well, in a London School of Economics lecture a few weeks ago: He said, 'If you were to cut short-term rates, or not put them up, this will probably be put up long-term interest rates because people would be worried.' So, in other words, it's totally the obverse of what a well-known person sitting in the White House might think he wants.

AB [53:53]: . I'm not going to comment on the president, but I think François put it very well because I think that if you don't respond - or if you don't do what you need to do - to get inflation back to a point of price stability, whatever that is in your regime, then the risk , as you rightly put it, is that you will actually cause long rates to go up because people will lose confidence in the regime. So I think that is a very clear point, and I think François was absolutely right to make it.

DM [54:24]: It's easier for him to do it since he's now officially retired from the central bank. He may, of course, take on another job. We just don't know about that. We're coming towards the end of the conversation now. I do want to ask you about the competition for capital, which we see this now as a factor behind higher rates in Europe as well, we see this boom taking place in the artificial intelligence sector. Some of this may end in tears, but for the time being, it's a tremendous boom. Who knows? Have you got any feeling yourself whether this may end up in a bust? At the moment, it's a competition for capital which is helping to drive up the interest rates at the longer term of the market. Would you like to put that into perspective, given the fact that we do have higher public deficits and more government borrowing at the same time?

What opportunities and risks does artificial intelligence create?

AB [55:12]: Let me let me offer a few thoughts on that. Some which I said in the G30 seminar last Saturday. The first thing to say is that for many economies, UK included, it's very important that we have have a higher potential growth rate. We've had a lower potential growth rate for the last 15 years or so than we had before the financial crisis, That isn't an easy background in which to operate economic policy generally. So, seeing an increase in productivity growth, for instance, which raises the potential growth rate, would be a very good thing all round. So, I would certainly support the investment that needs to go in to create that . That is a good thing. Now when you look at the UK and the US. We're in different places. So the UK, one of the interesting things that we've seen over the last 15 years is that we've seen a restructuring post-financial crisis of household and company balance sheets. So UK balance sheets and the private sector households and companies are in a very robust position. I would say that has allowed us to have resilience through a period of big

shocks, and that's a good thing. I think the US is a bit different because they've had stronger growth. That's the benefit they've had, but you are seeing big expansion in the investment economy now. Is there a bubble? Is the question you posed as a result in relation to tech and AI. And go back to what I said at the G30. Look, none of us know, but there are at least four reasons why we have to watch this very carefully, because we could see some correction.

The first is that it's the job of financial markets to value the future returns of this activity, the future productivity growth embedded in it, and that's a forecast. So we could get higher growth and higher productivity, but the markets could overdo it, and you could get a correction. Second, in history, with these big general-purpose technology waves, things that tend to increase growth for a sustainable period of time, the benefits tend to take longer to come through than people think…

DM [57:38]: … they say, don't they, 'I saw IT everywhere except in the productivity numbers'….

AB [57:42]: Yes, Bob Solow's comment. It took about 50 years between Edison wiring a light bulb up, and then coming into productivity. Now, I think the world the world moves faster these days, but that could still be the case because you need complementary innovations to put this stuff to work. The third one is everybody's priced to be a winner Remember Netscape? Netscape was one of the original 'winners' in the internet ICT period. It doesn't exist anymore. The fourth one is the one that has really come into my thinking in the last few weeks, when there's very big borrowing to support this innovation, to support this investment.On the AI front, the big issue now is what I call public trust.

And what underlies public trust is people saying - outside our world really – 'How do we get the acceptable level of human control over this stuff?' The reason I say this is that I think the financial stability position from the borrowing , and the public trust issue, do come together. If we lose public trust, or don't establish public trust, then that's going to make the financial position look more precarious. So these two things are interlocked.

How should the Bank review its performance and strengthen accountability?

DM [59:02]: Yes, these issues, which are coming up quite a bit in the US now, I think are going to make a difference. The public social issues, I think, do intermingle with the monetary. Just time for a couple of questions. One comes from the audience also regarding these five committees that Mr Warsh set up on things like communications, data, stuff like that. Is there any need for the Bank of England to do anything like that? We always say that whenever the Bank of England doesn't quite know what to do, it sets up several committees. So perhaps that's not the right method. But what would you say?

AB [59:36]: We had Ben Bernanke do his review….

DM [59:41]: … you are making some changes through the modelling apparatus? He said your computers are out of date….

AB [59:46]: We obviously did the Bernanke review. I thought it was a very good thing to do. But if you go back further, Mark and Mervyn both did, and Eddie did reviews as well. So we've we've had more of a history probably of doing reviews.

DM [59:59]: So no more reviews. Not needed, not on your watch anyway.

AB [1:00:03]: We're not planning a big outside review at the moment. We've got, as you said, we've got the Treasury Select Committee work going on, but we're not planning one at the moment. We do, however, have regular reviews. We internally have what used to be called the Independent

Evaluation Office. We've got the National Audit Office look over us. We've got the IMF doing a financial stability FSAP process at the moment. We're not short of reviews

What has defined Bailey's governorship and what should the next governor bring?

DM [1:00:31]: a couple of questions right at the end, just because we you are coming slightly to the end of your mandate, although not as close as some people. When you look back, Andrew, at this time, now it's it's been now nearly seven years. What is the best and what is the worst thing that you remember about this time?

AB [1:00:51]: Well, the best. Sorry, this is this sounds I know a bit general. The best thing is, you know, look, I love my job. I love what I do. I'm incredibly proud of the Bank of England. I regard myself as 'I'm looking after the Bank of England for my term, and I want to pass it on to my successor.' I've been at the Bank of England 40 years, you know. It's it's an amazingly important institution, and I'm you know I'm always amazed by the people I work with.

DM [1:01:16]: So what about the worst thing?

AB [1:01:17]: Was I mean look, COVID was hard. I mean I will say this, you know, as you said, my first week, you know, we had a meltdown in financial market. I started on Monday. We had a meltdown in financial markets on Wednesday. We had to have emergency monetary policy, and we had the national lockdown end of the week. 'What did I do wrong?'

DM [1:01:38]: 'Why did I deserve it?' As you say, some people have all the luck regarding timing. The final question: I know we haven't quite got there yet, but let's say you're a personnel consultant. You are not AB, but you're putting together a job spec for the next governor of the Bank of England. It may, of course, be you.

AB [1:01:58]: There's only one person. Well, I suppose a few more, but there's one person it cannot be, and that's me.

DM [1:02:04]: You cannot be reaffirmed. That's ruled out. But what would you put down as the job requirements in that in those advertisements that are going to go into the Economist magazine in about a year's time? What are the top three things that are needed?

AB [1:02:21]: I think you have to have a very clear sense of the importance of public policy. In the central banking world, you do have to have a very clear sense of how the pieces fit together. I regard one of my jobs here as how do these pieces fit together. You know, financial policy, monetary policy, financial regulation, payments. We haven't talked about payments. We've run out of time for that. There's a lot going on in the payments world, and what is the essence of central banking? I get asked when I go to schools around the country, which I do quite a lot. I say seriously, but slightly as a bit of a joke. We're in the money business. You know, money is the foundation of what we do. We've had to think very hard about the meaning of money in the context of payment innovation, things like crypto, and I think that will that will continue.

How might digital payments change central banking and cross-border links?

DM [1:03:07]: You've almost answered the question. But payments is an interesting area. We won't have time for this now, but as you know, one of my issues is that I think the digital age that we're in, with the digital gilt that will come along before too long could be a very good way, I think, of linking up to the euro area, where they will have a tokenised asset for the Bund market, for example. So I do think that these technological developments in payments could have some political repercussions.

So I don't know whether you want to comment on that. Bearing in mind that the prime minister has been recently talking about different options for bringing about a rapprochement between the EU and the UK.

AB [1:03:44]: I know we'll set all sorts of conspiracy hares running but work we're doing on payments is not a secret plot to go back into the EU. But, of course, you're right. The technology is common to all. It's all the same digital technology for all of us. So we're all basically doing somewhat similar things.

DM: On that note, I'm very pleased to say the Daily Mail will not have a headline tomorrow about going back into the EU, so as a result of payments. I'm very pleased about that. On that note, Andrew may I say thank you very much indeed.

AB: Always a pleasure.

DM: Thanks very much, until next time. All the best. Thank you for talking to us. Goodbye from me and goodbye from Andrew too. It sounds like the Two Ronnies, I know.

AB: You're looking very well if you've just come back from Japan .