House of Commons
Treasury Committee

# Re–appointment of Mervyn King as Governor of the Bank of England

## Tenth Report of Session 2007–08

### *Volume II*

*Oral and written evidence*

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## 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*)
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### 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.

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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).

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# Witness



# List of written evidence

# Oral evidence

## Taken before the Treasury Committee

## on Tuesday 29 April 2008

Members present:

John McFall, in the Chair

Nick Ainger
Mr Graham Brady
Mr Colin Breed
Jim Cousins
Mr Michael Fallon
Ms Sally Keeble
Mr Andrew Love
Mr George Mudie
Mr Siôn Simon
John Thurso
Mr Mark Todd
Peter Viggers

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*Witnesses:* **Mr Mervyn King,** Governor of the Bank of England, gave evidence.

**Q1 Chairman:** Governor, good morning and welcome to the committee. Can I ask you to introduce yourself formally for the shorthand writer, please?
***Mr King:*** Good morning, Chairman. I am Mervyn King, Governor of the Bank of England.

**Q2 Chairman:** Welcome to the committee and congratulations on your re-appointment. We have a few engaging questions for you over the next few minutes. When were you first approached about your willingness to be reappointed and when were you told that you were being reappointed and by whom?
***Mr King:*** The Chancellor approached me a few days before the announcement was made. There were no discussions at all before that and it was the Chancellor who discussed it with me.

**Q3 Chairman:** But there were suggestions in the press last year that your reappointment was unnecessarily delayed. Did you have any concerns about your reappointment or a sense that you were temporarily on probation?
***Mr King:*** No. I think it was perfectly reasonable that it was not discussed until the New Year, because when it came up, frankly, unusually, as you know, because of the financial crisis, everyone was extremely occupied dealing with the problems of overcoming that crisis. I thought it was quite reasonable to defer it until after Christmas.

**Q4 Chairman:** On the Special Liquidity Scheme that has been announced, who signed that off: yourself or the Chancellor?
***Mr King:*** It was agreed between us. I put the proposal to the Chancellor, but it required his approval because it involved the creation of Treasury bills, which could be then swapped with the less liquid securities of the banking system, so it did require the Chancellor to sign that off.

**Q5 Chairman:** You have been very strong on the issue of moral hazard over the past few months. How have you avoided moral hazard in the design of the liquidity scheme?
***Mr King:*** First of all, I think the motivation for introducing the scheme came out of the events in March. Unlike the period in the Autumn, when spreads between the LIBOR rate and the expected policy rate rose and then fell back as banks accumulated liquidity, in March banks were not short of liquid assets but there was no confidence in being willing to deal with each other, and that lack of confidence in the banking system, which was evident around the major financial centres of the world and clearly most evidently in the failure of Bear Stearns, meant that we were really very concerned that almost any bank could be subject to rumours or a run at the wholesale level, and so we decided to introduce the scheme to deal with that problem—to put a scheme in place that would bolster confidence in the banking system so that a particular bank that was thinking of dealing with other banks could be confident that those other banks could, indeed, obtain access to liquidity. That was the motive behind the scheme. So the circumstances were different from those in the autumn, but the way we have protected against moral hazard is by ensuring that the credit risks stayed with the banks, and we have done that through the haircuts we have imposed on the assets—if you want to swap liquid assets for illiquid assets you have to post a much higher value of the illiquid assets in order to get a particular value of the liquid Treasury bills—and we are also imposing a fee on the banks that take part in the scheme. So I do not think this is, by any means, something that banks would access unless they felt they needed access to liquidity, and in that way we have protected the concerns about moral hazard which, I think, are very important and I stick to, and I have not changed my mind at all on that because this is important in terms of ensuring that we do not go back into a situation where there is a financial crisis again in the future.

**Q6 Chairman:** Kick-starting the mortgage market, was that a big factor in this Special Liquidity Scheme?

***Mr King:*** No, this is a scheme to help the liquidity of the banking system as a whole and restore confidence in the banking system. It is not designed to, so-called, kick-start the mortgage market; indeed I think it would be a serious mistake to go back to where the mortgage market was a year ago. There is the need for an adjustment in the mortgage market, but I do think that the improved confidence in the banking sector which I think the scheme will eventually restore will feed through to borrowers and we will see the mortgage market operating on a more normal basis.

**Q7 Chairman:** So you think we will see credit conditions in the mortgage market easing markedly?
***Mr King:*** I think we will see the spreads between the official policy rate and the rates charged by borrowers stop increasing. They have been moving up in large part to unwind the unnatural compression of spreads that took place in 2006 and the first half of 2007, when the spreads reached levels that were clearly not sustainable. I think people often forget that when we were raising interest rates in that period the mortgage rate did not rise one for one with the bank rate; so it is hardly surprising that it is not falling one for one with the bank rate now.

**Q8 Chairman:** At the end of March you called for a willingness to contemplate radical change to banking regulation. Are you attracted to the case for central banks to act to restrain bank lending during booms, as advocated by Charles Goodhart?
***Mr King:*** Let me be clear what Charles Goodhart has proposed. As I understand it, what he is proposing is that the capital requirements on banks would be raised after a period in which there had been extended profitability, rising asset prices, in general a period of some stability and success for the banking system. That would give a greater capital cushion if and when there were to be a sudden fall in asset prices. I think there is some merit in the underlying idea, and that is something which the Financial Stability Forum is going to take up and examine, as will the Basel Committee. Of course, to turn the idea into practice is not straightforward, not least because to be really effective I think these rules and regulations do need to be applied internationally. That is not a reason for not being willing to take action domestically before that if we feel that is necessary. I think the basic idea is well worth exploring, and I hope it will be, and I am confident that the international bodies dealing with this will do that.

**Q9 Chairman:** Turning banking theory into practice, it would be easy, would it not, for example, determining the appropriate level for capital ratios at any particular point in the economic cycle? Would that not probably turn out to be more art than science?
***Mr King:*** It certainly will turn out to be more. It will be both art and science. I think the science is behind the principle and the art is turning it into numbers in practice. I think there would inevitably have to be a degree of discretionary judgment, but that is not to say it may not be worth trying to achieve that, so I do see some merit in it.

**Q10 Chairman:** If an international solution is needed, as you say, what are the prospects for a Basel III to be devised and implemented during your second term as Governor?
***Mr King:*** Slim, I think. Basel II has not even been implemented in the United States, and I am not at all sure when it will be. It has taken many years to get from where we were to here, these things do move slowly, but I think most people involved in the process feel that the attempt to ensure a level playing field internationally, given how international banking is these days, is well worth the effort and time spent on it. I would like to think that the Basel Committee would think about questions which have been raised by the Financial Stability Forum about whether capital and liquidity regulation are demanding enough by way of capital provisions by the banks, sooner rather than later, but I do not think I would be optimistic about a Basel III in my lifetime at all.

**Q11 Chairman:** If there is going to be a Basel III at some stage, would such a new agreement include any regulations for banks' holdings of liquidity?
***Mr King:*** Undoubtedly. I think if you look at the history of the Basel framework, it is quite instructive that the Bank of England was at the forefront of suggesting that the original Basel proposal would place requirements not just on the asset side of the balance sheet but also the liabilities side. That was not taken forward at the time, but I think it does need to be now. I am quite convinced, and, indeed, there is a working party meeting already under the chairmanship of one of the directors of the Bank of England, Nigel Jenkinson, to examine these proposals, so there is no doubt, in my view, that looking ahead Basel II will be modified in various ways, both to put greater emphasis on the need for liquidity regulation and, I think, to look at this aspect of whether Basel II, as it currently stands, is too pro-cyclical and does not do enough to ensure that capital is built up in a good time so that it can be run down in the lean times.

**Q12 Chairman:** What would be your idea of the ideal for banks' holdings of liquidity?
***Mr King:*** It depends very much on the structure of the liabilities. I think it is a detailed issue; it is not just a question of a single number. I think one of the big challenges for all regulators is that the nature of the instruments that can appear on both sides of the balance sheet change all the time as new instruments are invented, and I think the regulators have to keep up with them.

**Q13 Chairman:** There has been a lot of talk in the past few months and we have been focused so much on the banking sector and finance, some commentators would say, that we could be forgiven if some people think we live in a post industrial society. Last month you emphasised in evidence to

us that finance was a means to an end. Are there particular steps that could be taken in the coming years to see how finance can assist manufacturing and the real economy more generally and, thus, be the servant rather than the master of the economy?
***Mr King:*** This goes to the heart of all the issues about how far we promote London as a financial centre as an end in itself and about the type of remuneration structures that persist in the City. I do think it is rather unattractive that so many young people when contemplating careers look at the compensation packages available in the City and think that these dominate almost any other kind of career—that is not an attractive position to be in. Such a high proportion of our talented young people naturally think of the City as the first place to work in. It should not be. It should be one of the places, but not the only one. These are cultural factors. I think that banks have come to realise, in the recent crisis, that they are paying the price themselves for having designed compensation packages which provide incentives that are not in the long run in the interests of the bank themselves, and I would like to think that that would change.

**Q14 Chairman:** You have bank agents all over the country. I would not like this session to finish today without some message to the wider country about the economy. The Bank of England is there to help the Government. Indeed, I have heard you in speeches you have made in the past articulate about the good companies that are out there, private companies all over the country, and they need to help them. So what is the message for the rest of the country here today other than City of London centric issues?
***Mr King:*** The Bank of England exists to ensure a prosperous economy throughout the whole of the United Kingdom. Indeed, from day one, when I was appointed Governor, I set out deliberately to spend less time in the City than my predecessors and more time going out to every part of the United Kingdom. I have kept that up right through the first five years of my governorship and I intend to carry on doing that. If you were to ask what companies have impressed me most during my five years as Governor, it would not be the large institutions in the City, it would be many smaller, medium-sized, often privately owned companies in the rest of the United Kingdom economy who are paid far less than people in the City, who may be operating with two or three thousand employees, exporting to a dozen countries, and they have a tiny number of highly qualified people working with them. The other employees are ordinary people, drawn from the community, who are highly motivated. These companies have excellent products: they do the most surprising things, exporting to China ordinary manufactured products. When my first natural question to them was: "How can you compete with the Chinese?", the response was, "We export to China." There are many companies like this. The big thing is not to generalise but to go and look for examples of companies. Some companies do extremely well, others less well, and the quality of the management is largely the factor which determines that outcome. I think it is absolutely crucial that we do not lose sight of the fact that the monetary policy is there to ensure steady, sustainable growth of businesses up and down the country that provide employment to the people who live there.

**Q15 Chairman:** So you think this crisis that we have been through in the past few months could herald a new outlook, a new consideration, for the wider aspects of the economy?
***Mr King:*** I think we will see it a little more in perspective. I think we have seen a decade of enormous success for the financial sector and it culminated in excesses that led to a very unsuccessful period of a year or two, and I think we will need to put those together to get a more balanced view about what is the sustainable picture for financial institutions in the longer run. I think all of us, and I do not exclude the Bank of England in this, have learnt a lot of lessons from the last nine months.

**Q16 Ms Keeble:** I wanted to ask a little bit about inflation. Obviously, and it shows from your own Inflation Report, inflation is measured by CPI, and I am particularly concerned about public perception. How do you think that might impact on wage bargaining?
***Mr King:*** It is very hard to judge. I think we have been surprised so far at how little response there has been, in terms of wage settlements, to the developments in inflation, first in the early part of last year when inflation rose and then fell back and then again so far this year. I do not think we can assume that this will necessarily continue, but I think it is encouraging that people have focused on the circumstances of the particular businesses in which they work and the competition of the labour market, rather than developments in inflation. That has helped to ensure that wages have grown at a very steady rate.

**Q17 Ms Keeble:** In terms of people's obvious experience of food price increases and also mortgage price increases as well, are you concerned about the increasing pressures there and the impact that is going to have on the ability of the MPC to control inflation?
***Mr King:*** I think everyone is concerned by it, because it is a factor from the rest of the world that is depressing living standards in the United Kingdom. That is something which is not attractive in itself and I think makes, in the short run, the task of keeping inflation close to the target more difficult. So, yes, we are concerned, but what I would try to draw to everyone's attention is the fact that the CPI, much maligned, does actually include all of these things which are going up in price—it includes food prices, it includes energy prices. All of the things that people are drawing attention to at present are, indeed, in the CPI.

**Q18 Ms Keeble:** Over the past ten years you have pointed to the fact of the enormous excess of the banking and financial sectors, and you have

obviously been a big part of that, as has the Government, and I think everybody has acknowledged that. During the coming years, however, because of the recent turbulence, there is going to be increasing importance on dealing with the issue of public confidence and public perception. I think we saw that through the Northern Rock debacle. In the past I would say that you have fought shy of actually dealing with the issue of public confidence, and I wonder if, going forward, you feel there are particular things that you could do or a particular role for the Bank in addressing this really key problem of public confidence?
***Mr King:*** This is public confidence in the ability of the MPC to keep inflation close to the target?

**Q19 Ms Keeble:** In financial stability, public confidence in inflation, the credibility of the Bank's inflation figures and, therefore, people's confidence in the financial system generally.
***Mr King:*** I would like to draw a distinction between the two, if I may, and I do that because I think experience shows, historical experience shows, that it is possible over a number of years to control inflation and keep it close to a target that we have been set. Financial crises have occurred regularly for 300 years or so and nobody has managed to find a solution to the existence of financial crises. Every developed country has had financial or banking crises at regular intervals, so I think it would be optimistic of me to claim that we can guarantee there will be no financial crises at any point in the future, although I do think we can argue with people convincingly that we will have put in place, once the recommendations of your report and the new legislation which the Chancellor intends to introduce is passed by Parliament and becomes an Act, a framework to deal with failing banks. In terms of public confidence in the inflation target, I think the MPC as a whole has put in an enormous effort in going around the country talking about the process which enables us to keep inflation close to the target and about their own individual views. I think that the framework we have, which is based on clarity about the objective but an open discussion and debate within the Monetary Policy Committee about the right level of interest rates each month to achieve that, has both combined the benefits of educating the public about what we are trying to achieve but also not pretending to them that anyone with any sense always agrees at any given moment what the right answer is. There is always scope for differences of view, and when I have spoken to business audiences, the fact that the MPC sometimes has disagreements within the committee, they feel, is a sign of strength, because they feel at least all the arguments are being put, they are being heard, they are being discussed.

**Q20 Ms Keeble:** With all due respect, it was not the business community, by and large, which triggered or which did the run on the Northern Rock, it was people with savings, it was the wider public. How do you feel that, as things move forward, yourself and the MPC are going to be able to win the confidence or instil confidence in the wider public, or do you not see it as being part of your job?
***Mr King:*** The MPC was not set up in order to ensure financial stability. Indeed, one of the main motives in separating banking supervision from monetary policy by creating the FSA was precisely to avoid what your Government said at the time was potential reputational contagion from financial stability to monetary policy. So that clear separation between financial stability and monetary policy was very important, but I do think that the terrible problems that occurred at the time of the run on Northern Rock would be prevented in future in that form by the very changes that you yourself recommended in your excellent report.
**Chairman:** Can we have brief questions and brief answers.

**Q21 Ms Keeble:** The inflation target does not include mortgages, which was one of the other factors. What is your comment on that?
***Mr King:*** I have said for some time that I would like the Consumer Price Index to include house prices in some form, because they represent the price of consuming the services of housing. Rental housing is involved, but not owner-occupied housing, and, indeed, this is a harmonised measure across Europe. EUROSTAT has said for some considerable time that they wish to include housing and are consulting on how best to do it, and I regularly report back to this committee to explain why nothing has happened and no doubt I will carry on doing that.

**Q22 Chairman:** You did mention to us that it was another Basel III, was it not? It will not be in your time as Governor.
***Mr King:*** Unlikely, I think, but you never know: stranger things can happen! In the long run that change would be desirable, unquestionably.

**Q23 Mr Fallon:** That must be right, because the Consumer Price Index excludes owner/occupied housing costs, and chart 12 in your quarterly bulletin shows that for public inflation expectations a year ahead for the first seven or eight years of the MPC's existence people seem to have broadly believed inflation would be between 2-2.5% but now believe that it is well over 3%. How are you going to get back public confidence in the inflation figures?
***Mr King:*** It is quite likely that those expectations are expectations focusing primarily on the next 12 months and, of course, it is likely that inflation in the next 12 months will hit 3%, and possibly higher, because of the impact of higher food and energy prices. The committee have judged it would not be sensible to raise interest rates significantly at this stage inducing a recession in order to try and keep inflation below 3%. We are looking through that short-term peak in the belief that, as long as food and energy prices do not continue to rise at the same rate—although they could stay at these high levels—inflation would fall back. Our task is to try to make sure that we do not see any signs of second-round effects on further price and wage increases which

would mean that inflation would stay at those levels. We want to bring it back to the 2% target. That is a very difficult balancing act. But we did achieve it last year, for example. There were people who, in the first half of 2007, said when the March figure hit 3.1% that we had lost control of inflation. We said that, in our judgment, we had not, that we thought inflation would come back to the target, and, indeed, by July it had come back to the target. The challenge we face now is greater, because the period over which it is likely to be close to 3% is longer than was the case last year, and we have seen further increases in wholesale gas prices, which may yet stimulate more increases in gas and electricity prices. Our task is to convince people that we will take the measures necessary to bring inflation back towards the target over a reasonable time horizon to avoid, as the remit says, unnecessary volatility and output. In the end the proof of the pudding is in the eating, but we are absolutely focused on it, as I think you can see from what we say and actually the debate that the committee is having.

**Q24 Mr Fallon:** But your own survey figures show that inflation expectations have been rising since February 2005. This is not something that is happening now. Since February 2005 people have started to believe that inflation in the year ahead is going to be much higher than 2%, and that is obviously now feeding through into public sector wage rounds?
***Mr King:*** So far wage settlements have been remarkably restrained and there has not been any pick-up. Indeed, all the evidence we have suggests that, if anything, wage settlements are running at a slightly lower level than they were last year. I do not take that for granted, and I certainly am concerned about the rise in inflation expectations—there is no question about that. How accurate these data are, I do not know, but we are quite determined to bring inflation back to the target. That is our remit.

**Q25 Mr Simon:** When you were out-voted last summer on the MPC, Roger Bootle wrote that the reason this was a problem was that you were not just its chairman but its intellectual leader. Are you its intellectual leader?
***Mr King:*** No, there are nine intellectual leaders on the Monetary Policy Committee—not that many followers but there are nine intellectual leaders.

**Q26 Mr Simon:** If you were the intellectual leader, if the Chairman were to be the intellectual leader, would that be a problem?
***Mr King:*** No, I think it would be rather a shame if the Chairman of the Monetary Policy Committee had no alternative but to exhibit intellectual leadership. That is very much what the Monetary Policy Committee's task is: to analyse what is happening in the economy and decide on the appropriate remedy.

**Q27 Mr Simon:** How do you measure, how do you benchmark your success as a chairman?
***Mr King:*** I think, in terms of the reactions of other members of the committee: whether they feel they have had a full opportunity to express their views, both in the committee and outside it, and whether they feel that the process we are pursuing, both in the monthly meetings and the quarterly forecast rounds, is a process that gives them all the information they need to reach their decision. I think this is a question that you will have to put to other members of the committee. The Court to the Bank does carry out an annual survey on this where the Chairman of the Court has a private meeting with all the members of the Monetary Policy Committee, including the external members, and among the questions that they are asked are questions about the Chairman.

**Q28 Mr Simon:** Speaking of the other members, do you expect to be consulted when the criteria for the new appointment are drawn up?
***Mr King:*** Yes. I think it has been agreed that I would certainly be consulted about the qualities and attributes that a particular new member should have, in order to keep some balance on the committee.

**Q29 Mr Simon:** Are there any even greater or new additional qualities and attributes that you might be looking for that you have not got represented already?
***Mr King:*** No, I think we have got a pretty good and well-balanced committee, so I am very happy at the present time. I hope the committee stays together.

**Q30 Mr Simon:** If they were to advertise openly for a new deputy governor, would you expect to be consulted on the criteria for that?
***Mr King:*** Yes, I am sure I would be.

**Q31 Mr Simon:** Do you think you should have a veto over such appointments?
***Mr King:*** I do not think anyone has a veto. These are clearly, by statute, the appointments of the Chancellor, but I think the Chancellor would certainly not want to impose on me a candidate whom I could not work with.

**Q32 Mr Simon:** Can you imagine such a person?
***Mr King:*** No, I do not think so, but we will have to see. It is impossible to judge until I hear names, is it not? If you are going to advertise it, I await with interest to see the names of the people who apply.

**Q33 Mr Todd:** Turning to financial stability, the events of last summer have presumably led you to review the team and the focus of the team engaged in financial stability work at the Bank. Can you set out what has happened since then?
***Mr King:*** I think what it has led us to do is to ask questions about the framework in which we carry out our work on financial stability. The big concern that I had had before the events of last August, which led to the rewriting of the Memorandum of Understanding, was that the Bank was assumed to have responsibilities which it could not deliver because it had no powers or instruments to do so.

The redrafting of the Memorandum of Understanding, which was completed in 2006 early 2007, was designed to ensure that the responsibilities attributed to the Bank were matched by the powers that we had. Of course, many things are now up in the air and, without knowing the outcome of the consultation and the Chancellor's decision on how the new framework in the Banking Bill will be implemented, it is impossible for me to know at this stage what powers will be given to the Bank and, therefore, how we should re-organise our team.

**Q34 Mr Todd:** For example, when you were appointed there were around 150 members of the Bank staff who were engaged in financial stability work. Have you increased that number, changed that resource in some way?
***Mr King:*** No, the number was nearer 180, and we have reduced that quite significantly in order to sharpen the focus on the work, because you do not have 180 people to write reports on all kinds of things, what you need are people who are absolutely focused on the key issues. The question was: how did we decide what were the key issues? How could we make the area really operational? What was its role? The only powers we had really were to make speeches, write reports and draw attention to the risks; so we re-organised the work in order to focus very much on how we would identify the main risks.

**Q35 Mr Todd:** Roughly what number are we talking about now?
***Mr King:*** One hundred and twenty.

**Q36 Mr Todd:** The two deputies you have are both career civil servants. Do you think that deputies should have senior bank experience in addition to any other attribute they bring to the job?
***Mr King:*** I think it depends entirely on the individuals, but I remember saying to the Chancellor's predecessor that it was very important in the Bank, as it was in the Treasury, to ensure that there were routes for internal promotion. We have an incredibly talented group of younger people in the Bank and in many ways what I would like to see when I leave the Bank is that group of young people having come through, not necessarily to deputy governor but to a variety of senior positions. They are the generation that will run the Bank in the future. I have immense confidence in them and I look forward to being able to hand over to them in due course.

**Q37 Mr Todd:** You might be hinting that the use of the deputy governor position, which you have said in earlier answers lies with the Chancellor, perhaps should be seen as a clearer linkage to bank career progression than shuffling civil servants into safer berths where they have had problems in the past?
***Mr King:*** I think you have to judge individuals on their own merits and not try to generalise too much. All I would say is that in the current Monetary Policy Committee eight of the nine people were appointed to their positions from outside the Bank. I was appointed to a Monetary Policy Committee position, as it would have been then, from outside the Bank. I think it is important that we ensure that there are adequate routes for promotion within the Bank given that we have such an incredibly talented group of young people there.

**Q38 Mr Todd:** Do you think that there is enough exchange between the young people you have in the Bank and the banking world outside to give the breadth of experience that may be desirable in financial stability work?
***Mr King:*** We have, and we are expanding quite rapidly, a programme of secondments, and that will include the banking world, but I think it is very important to remember that a central banker is not a commercial banker. There are very few commercial bankers in senior positions in central banks around the world—so that is not a trend. I think experience in other institutions outside the Bank of England can be very important as part of a career development programme. One of our talented younger persons is now working for the Federal Reserve for two years, playing a very important part there in their communications programme. That will be invaluable experience when that person returns to the Bank of England. We are looking and expanding this range of opportunities.

**Q39 Mr Todd:** Are you happy with the progress on the proposed legislation to remedy the defects in the framework for handling failing banks?
***Mr King:*** Yes, and I think it is important not to rush this unduly.

**Q40 Mr Todd:** We are not.
***Mr King:*** No. You published a very comprehensive report with recommendations in it. There was a consultation, the tripartite authorities published a consultation document, but the period of consultation on that has only just ended a few days ago. Now is the time when we need to read the consultation responses, reflect on it and then put the legislation in place. I think it is all going pretty well. I think it is quite remarkable that a year from now we could be looking back on a period of 18 months in which, yes, we did go through a terrible problem with the run on Northern Rock, but at least we have come out of it with a decent legislative framework which would make it very difficult for that problem to recur.

**Q41 Mr Todd:** Consultation did not specifically refer to the prompt corrective action powers that exist in the USA.
***Mr King:*** No, but it is open to people to suggest that.

**Q42 Mr Todd:** Which has no doubt come up in the comments that have been—
***Mr King:*** I would hope so. I do think these are important questions and it is very important not to think that just a few minor changes to the current framework would be enough. I think, as your own report of your committee suggested, it does require root and branch reform to put in place a special resolution regime. I very much welcome that.

**Q43 Peter Viggers:** Financial stability is a very broad and general concept. Do you think it can be defined meaningfully in legislation?
***Mr King:*** I think it is extremely difficult, which is why I have always tried to ensure that you start with a description of the powers of the Bank of England, the instruments it has to pursue financial stability and then carve out a description of what the financial stability role of the Bank of England is in terms of those powers. You can talk about the absence of financial stability and people have written endless treatises on this; I do not think it gets us very far in terms of a sentence or two in a statutory framework. The key thing is not so much the general words; the key thing is to decide what powers, if any, the Bank of England should be given in this area. Once you have answered that question, I think we can find some words to describe it.

**Q44 Peter Viggers:** In your memorandum in response to our questionnaire you talked about adopting a model of graduated bank involvement at times of financial difficulty, ranging from a time when the FSA would be responsible for regulation through to periods of severe stress where the Bank of England would take the lead. That does seem to me to require quite a lot of resource so that, if the Bank is called in, it has enough background knowledge to handle each individual situation. At the same time you have stressed to us that you are determined that the Bank will only accept new obligations if it is granted sufficient powers and, presumably, resources to meet them. Are you satisfied and confident that the Government accepts this point?
***Mr King:*** I think the general point is accepted. I think there is a question to be decided as to what powers the Bank would be given—that is the big question to be debated—but I think that there is agreement that, if the Bank is given powers, then it will require the resources and be held accountable for the exercise of those powers. What I think we cannot do is to accept a responsibility for something that we are in no position to deliver, which I think was the problem with the initial Memorandum of Understanding.

**Q45 Peter Viggers:** It is envisaged that the Court will have a role in overseeing the Bank's performance relating to financial stability. What advice would you give to the Court in undertaking this responsibility?
***Mr King:*** I think to be very clear what the powers of the Bank are and then to set up mechanisms for which an appropriate degree of oversight can be held. We have already discussed this a great deal at Court. There have been enumerable discussions and Court in recent years has tried to work out what exactly the Bank's role in financial stability really is. We have always come up against the problem that without powers you cannot really define easily such a role. I think Court now feels quite strongly that the Bank should be given more powers and it is prepared to exercise the oversight of that.

**Q46 Peter Viggers:** Central bankers have built up a reputation for being rather Delphic in their utterances. Do you think there is scope for central bankers to be rather more specific and even to name and shame?
***Mr King:*** I am not sure if I have acquired a reputation for being especially Delphic. There are clearly things which people in any public position need to be careful about when talking and discussing in public, but I think the great attraction of our monetary framework is that the Government gives us the target that we are supposed to hit and that means that we then have a very clear responsibility to go out and explain the merits of that and what we are doing to try to achieve it. I think our life becomes a whole lot simpler when we have a framework like that, and that is why I am very strongly in favour of a framework in which the Government sets the target and we then set the level of interest rates to achieve it.

**Q47 Peter Viggers:** I was thinking in trans-Atlantic terms when I was using the word Delphic rather than of you and government. The US authorities have recently published their blueprint for the future of US regulation and they have rejected the concept of a single regulator moving towards an objective-based system of regulation. Do you think that this central bank will have to become more involved in the future in regulatory matters?
***Mr King:*** I think it always depends what you mean by "regulatory matters". I do not think we should acquire responsibility for prudential supervision. We have made that move now, the FSA have acquired it, they can look at all kinds of institutions, whether it is commercial banks, investment banks, insurance companies, but I do think that, in terms of the Bank ultimately having the potential for dealing with a failing institution, it is very important that the Bank has the ability to get involved somewhat earlier than was the case last August. One of the things that we learnt, one of the big lessons, was that in the end we were the lender of last resort to Northern Rock and our banking side of the Bank of England had contact with Northern Rock only three days before we became lender of last resort. We really knew very little about this institution. I think it is necessary for us to know more, and I think the FSA accept that—it is something we all learnt—and that the sort of information which the Bank thinks is important we should be able to ask for and have a right to demand information about banks with respect to particular aspects such as liquidity, which was our concern.
**Peter Viggers:** I agree. Thank you.

**Q48 Nick Ainger:** Governor, the credit crunch originated with major problems in the subprime mortgage market in the USA and it spread to the rest of the globe through the originate and distribute model and securitisation. You told us in our inquiry into financial stability and transparency that you thought that the originate and distribute model had real value and you did not want it to disappear and that you believed that the securitisation model would survive, but not in the way it has been operating in the last few years. How different do you think the market for securitisation products is going to be after we, hopefully, come out of the present problems?

***Mr King:*** I think there are two respects in which the market will be different. The first is one that is relevant really for the United States and less here. There clearly were problems, as the US Treasury has acknowledged, in the regulation, or lack of regulation of selling of mortgages in the US subprime mortgage market, and I think mis-selling is perhaps a charitable description of what went on in some of those instances. I think people will be somewhat reluctant to purchase securitised mortgages originating in the United States until those problems have been fixed. The second one that is relevant everywhere is to ask the basic question—and there is one word I have stressed through this whole episode, which is "incentives"—what are the incentives facing different players in the game? I think the reason for supposing that you could securitise mortgages and sell them in the market as a package rests on the assumption that the individual mortgages in the package are in some sense either identical or that, if there is a default, really you can use the law of large numbers: it is an individual event which is very rare and unusual—perhaps the break up of a family—and so you can aggregate mortgages into a large package and be pretty confident what the returns on the package will be. While house prices are rising and there is no trend in unemployment, I think that is a reasonable assumption to make; but when you see house prices falling, it is not a reasonable assumption to make. I think that what happened was that many of the mathematical geniuses who devised these instruments, as often happens in the academic analysis of these things, made one key assumption at the very beginning which they never went back to challenge. When house prices are falling you cannot assume that all mortgages are the same; you need to know very much where people live, not just the communities they live in but often the street they live on, in order to work out which mortgages might have a higher default probability. If someone offers you package of mortgages which originated in a period where you now know that the prices of those houses are falling, you may say to yourself, "I do not know anything about these people, but I bet someone further up the chain did, so why am I being sold this?" If you have that doubt about it, then you find that the market in those instruments cannot exist. So I think that a lot more information will need to be provided about the underlying mortgages for this mortgage-backed security market to reopen. I think that the question that will be debated quite actively is whether the institution originating the mortgages should be required to hold some portion of those mortgages and only sell on a portion, as opposed to selling the mortgages and then selling the whole package to someone else and pretending that they can rid themselves of any responsibility for the subsequent creditworthiness of those mortgages. These issues, I think, will need to be thought through before the market really reopens in a significant way.

**Q49 Nick Ainger:** I welcome what you have said, but to prevent recurrence should the regulatory authorities actually be getting involved in that detail of individual packages? How would the regulatory authorities ensure that in perhaps five or ten years' time we do not get again in a similar problem?

***Mr King:*** For the next five to ten years my guess is that the financial markets will remember this episode only too well and will not fall prey to that. It is beyond that that we would need to start to worry. I do think that what is perhaps most remarkable about this episode, as I said before to the committee, is that this is not a crisis that you can pin on the emerging markets in the world, or a slowing world economy, or even some tremendous macro-economic shock to the UK, like a doubling of interest rates. This is a crisis that came right out of the design of instruments traded among the most sophisticated financial institutions where they did not spend enough time thinking deeply enough about the incentive structure of those instruments. They may have looked very clever, but actually they were based on some very poor assumptions, and I think the managers of those institutions, who probably knew far less about those instruments than they should have done, will know in future that, if they want to keep their jobs, they will undoubtedly have to have better control over the design of those instruments. The problem is (and this is why I said earlier that we had had financial crises for 300 years) that each time you can identify what went wrong and each time for the next ten years or so the managers remember what went wrong the last time and make sure that it does not happen again, you gradually lose that collective memory and slip back into a position where, after a period of economic stability, success and expansion, optimism takes over and the willingness to be tough abates. If you think back to 2005, 2006 and the first half of 2007, those banks that were not engaging in what were described as innovative, exciting activities were often pilloried for being staid, boring, unprofitable institutions. It is a very difficult issue. I do not think the regulators easily handle it on their own. It is a question of taking a longer view and not just being carried away by success. There is a natural human instinct to interpret success as a sign of one's own ability as opposed, at least in part, to good luck. That is one of the key lessons.

**Q50 Nick Ainger:** Would you be in favour of requiring the banks to retain on their balance sheets a part of their securitisation packages?

***Mr King:*** I do not know whether I am in favour of it being a regulation. I am certainly in favour of them doing it. Whether it needs to be codified in a regulation, I am not sure. One of the problems with codifying in a regulation is that you get people who find that things which are not quite covered by the regulation must be all right to do. What you really want is to get the people who run the institutions to think deeply about the risks that they are facing. I think it is going to be impossible for any regulator to control all the risks that are being taken in a financial institution, but I do not know the answer to that. I think it is a debate that we need to have, not just over the next month or so, but over the next several years. We must not forget this episode; we must remember how it arose and have a proper debate about how it reflects on the quality of risk analysis, the compensation structures and the structure of our financial services industry. I do not think there are any simple answers, but I do think it is very important that we think them through, because financial crises (a) have occurred on a regular basis and (b) when they have occurred they have been pretty devastating. That is one of the differences between a financial crisis and a crisis in, say, motor manufacturing, or any other manufacturing industry, which tends not to have such a devastating effect on the whole economy.

**Q51 Mr Brady:** You have spoken about the importance of the Bank having earlier involvement in vulnerable banks, but how would you determine which banks are vulnerable?
***Mr King:*** I think what we did in the Bank was in a generalised way to ask questions about what has happened to the banking sector as a whole and what were the characteristics of some of those developments that we thought were most risky; and we did write a number of reports and spelt out in our financial stability reports and our speeches that we did think excessive reliance on wholesale funding, for example, relying very much for funding on selling into markets for instruments that could become illiquid, was a risky strategy, and we made that clear on a number of occasions. We have pointed, in general terms, to what kinds of institutions might be most affected by them. I think we have the ability to analyse these questions. It then requires the regulator to go into an institution and obtain much greater detail in order to find out how risky that institution actually is.

**Q52 Mr Brady:** You say in your submission to us that there would be a point at which the lead would be taken by the Bank of England rather than by the FSA.
***Mr King:*** I think that is only at the point where the bank needs to be taken under the wing of the authorities to resolve its problems because they have become so serious.

**Q53 Mr Brady:** Who would decide whether that point had been reached? Would it be the FSA or would it be yourself?
***Mr King:*** In a sense, it should be either. Either ought to have the ability to determine whether or not this trigger should be pulled and the bank go into a special resolution regime. Certainly the supervisor has to be able to withdraw authorisation—that goes without saying—but I do not think that should be left entirely with the supervisor, because, as many of my overseas colleagues never cease to point out, the reason why they have someone other than the supervisor with the ability to pull the trigger is because of their concerns about regulatory forbearance, the natural reluctance of a supervisor to announce publicly that the supervision regime has not been successful and the bank needs to go into a special resolution regime.

**Q54 Mr Brady:** Do you think regulatory forbearance was one of the problems with Northern Rock?
***Mr King:*** I do not want to write history; I think I will leave history to other people. I will merely make the observation, and it is a general observation, that many of my colleagues overseas see it as an important phenomenon.

**Q55 Mr Brady:** Last December when you came in front of us you acknowledged that there was a need to think about communication strategy during a crisis. Have you given further thought to that and, in particular, to the role that you would play as governor?
***Mr King:*** I think the most important part of communications is before you get into a crisis. There is no doubt that communications was not a high point of the events of last autumn. There were certainly lessons that I took for the Bank, which was that during August when the events in the financial markets started to unfold, I think I had probably made a mistaken judgment that I did not want to add to the cacophony of voices which seemed to me not to be shedding light but raising concern. I mistakenly kept quiet, and I wish I had given a speech or spoken out at that point. It was extraordinarily difficult during the Northern Rock problem, precisely because we did not have a framework in which it was possible to communicate in a way that would be other than misleading. Once that run had started, as I have said to the committee before, it was not possible honestly to say to depositors in Northern Rock, “Go back home. Do not take your money out of the bank.” There was no way in which anyone could have made that reassurance. I very much hope that if the proposals in your own report were implemented, in fact it would be possible to communicate effectively, because there would be something reassuring to communicate, namely 100% deposit insurance and a framework in which the bank could be resolved.

**Q56 Mr Brady:** What lessons have you learnt from the United States Government support for JP Morgan and the takeover of Bear Stearns?
***Mr King:*** I do not think there are very many. I think that the Fed clearly felt that over that last weekend it had no alternative but to push Bear Stearns into some kind of solution, it could not afford to let it reappear on the markets on the Monday Morning; so in that sense the option of a solution for Bear Stearns as a continuing bank was ruled out, but one thing that made in enormously easier was that they invoked unusual provisions in both the Fed law but also the law governing takeovers in the US. JP Morgan were able to acquire almost 40% of the shares without the approval of the shareholders and in that sense they managed to avoid some of the most difficult aspects of getting shareholder approval that we would have faced in the UK. I am

not sure that is a good reason for changing the law regarding takeovers here, but it was certainly a key element. It did not, of course, prevent them from having problems in dealing with shareholders, and the deal was, indeed, renegotiated a week or so later.

**Q57 Mr Brady:** Some people have drawn comparisons between Bear Stearns and what happened there and the potential takeover of Northern Rock by Lloyds TSB had they been able to move forward. What response would you make to that?
***Mr King:*** The old myth is reappearing, I see. There is not any obvious and simple comparison. The takeover law was different in the two countries and it was possible in the US to ensure that JP Morgan could acquire 40% of the shares in order to make it impossible for anyone to believe that that would be subsequently reversed. The Fed took on a lot of credit risk at the time which required support from the US Treasury. I do not think the terms of the process of takeover adds anything to what I said to the committee before.

**Q58 Mr Brady:** Finally, it is a hypothetical situation, but if Bear Stearns had happened first in September last year and Northern Rock had happened in March this year, how do you think your response would have differed?
***Mr King:*** I do not think it would have differed, frankly. Without a framework to resolve a failing bank, the options would have been extremely limited. With the benefit of hindsight, I think had we known what happened in Northern Rock last September and had a replay, there is no doubt we would have put in place the guarantee as soon as the support was announced, but, if you remember, at the time, as your own report makes clear, it was not obvious that the run would require the guarantee. The guarantee itself might have provoked the run, rather than the other way round, and, indeed, what was telling in all this was that Northern Rock itself was adamant that the announcement of the support should be made public because it believed it would help Northern Rock. If you recall, I wanted to do it as a covert operation, but that was not possible.

**Q59 Mr Fallon:** Governor, last autumn you said in a radio interview, "We are not here to do what the banks want us to do", and last week you seemed to do something the banks did want you to do. Given they have been extremely profitable over recent years, should not some shareholder payment, strengthening the balance sheets, have been a condition of taxpayer support?
***Mr King:*** I do not think the central bank can put, as a condition on a general scheme, that each and every bank in it should engage in capital raising, but I think what has happened in the last month (and it has become evident) was (a) the need to do something to restore confidence in the banking system and (b) the fact that banks themselves have come to realise that the market pressure is, finally, to reveal losses fully and then to raise capital, something which, you will recall, I made a point of when I came before you in December and mentioned again in a speech in January, and that is now happening and I welcome that.

**Q60 Mr Fallon:** But could it not have been a condition of the scheme that each of the banks strengthened their balance sheets?
***Mr King:*** I do not think it is true that each and every bank needs to raise capital. There are differences between banks. Banks have to make those judgments themselves and they will benefit—or not—from a subsequent market response. We have not needed to make it a condition. I think you can see the banks are now raising capital.

**Q61 Mr Fallon:** The discount that you are applying in substituting the Treasury bills for the assets they are transferring to you, the so-called haircut, presumably includes some assumption about the fall in UK house prices as well as the fall in US house prices that may be part of those assets. What is the Bank's assumption?
***Mr King:*** No, there is no direct assumption that goes into it, because what matters is how long it would take the Bank to dispose of the assets if the bank with which we had the swap were to default. Remember, this is only relevant in circumstances where the bank with which we did the swap were to fail, and in those circumstances we would keep the collateral, we would have the collateral and we would then want to market the collateral and sell it. What matters to us is what could conceivably happen to the value of those assets between the date of default and the date when we can sensibly sell them, and that depends on how long we think it will take before we can reasonably organise a sale.

**Q62 Mr Fallon:** But you spoke earlier this morning, when you were answering the Chairman, of the necessary adjustment in the UK housing market. There must be some assumption built into the level of the discount that reflects the Bank's view of that fall?
***Mr King:*** The assumption that is built into it is that, if house prices were to fall by enough to make us think we needed more collateral, then we have the ability to ask for more collateral. We do not need to assume at the outset what any fall in house prices might be because daily we can ask the banks to re-margin. If we saw the collateral becoming less of a cushion for us, then we would simply ask for more collateral, and we can do that at any point.

**Q63 Mr Fallon:** How can you be sure that lower LIBOR rates would actually mean a greater pool of lending for businesses and for consumers?
***Mr King:*** I do not think directly it does. I think the circumstances in which those rates would fall back would, in my judgment, be circumstances in which they would be willing to go back to a normal process of lending to the non-financial private sector because they would not be in a position of simply hanging and reducing their lending in order to scale back the size of their balance sheet. At present, I think, banks are worried about the expansion of their balance

sheet and they need to scale it back. Raising capital will help them. I think a combination of the Special Liquidity Scheme on the one hand and capital raising measures on the other will make it much more likely that the banks will get back to a situation where they can use the normal criteria for deciding on loans to the non-financial sector. I think it is worth stressing again that, even in the United States, and certainly here, there is this amazing discrepancy between the conditions in the financial sector and the housing market on the one hand and the non-financial sector and the rest of the economy on the other. It should not be a story full of doom and gloom. We have seen many shocks in the financial sector and it has been a very unhappy episode, but the rest of the economy has carried on doing remarkably well, and if you abstract from energy and look at the non-oil growth of the economy, even in the first quarter of this year it continued at 0.5%, an annualised rate of 2%, which is not far off its long-run average growth rate. So a sense of perspective is needed.

**Q64 Mr Breed:** A few moments ago, Governor, I think you said that it was about three days in August before the Northern Rock episode that the Bank of England became totally aware, as lender of last resort, of the problems?
***Mr King:*** Can I be clear what I said. I said the banking department of the Bank of England had contact with Northern Rock, and the things it had to discuss with Northern Rock were the collateral that it had available, the precise details of the collateral, so that we can act as a lender of last resort. Before that there had been no real contact between that part of the Bank's operations and Northern Rock.

**Q65 Mr Breed:** But, of course, the Deputy Governor, in charge of financial stability, was also a Board member of the FSA, and one might have assumed that for the few months preceding that there would have been greater knowledge of the background potential problems of Northern Rock at the Bank?
***Mr King:*** Can I try and scotch this one point very firmly on the head. The joint appointment of the Head of the FSA on the Court of the Bank and the Deputy Governor for Financial Stability on the Board of the FSA are to the general oversight and management of the two institutions and have nothing whatsoever to do with individual cases. So the Deputy Governor had absolutely no responsibility for the functional responsibilities of the FSA and their application to individual institutions and, equally, the Chairman of the FSA has no responsibility at all for what the Bank of England does. In some ways, frankly, I would prefer it if these joint memberships were to be abolished, because I think it just creates enormous confusion. It is not about information exchange. There is always information exchange at working level between the two institutions, but it is information exchange relevant to the responsibilities of the two organisations. The Bank of England had no responsibility for individual institutions. Therefore, that information was not passed to it until it got to the point after 9 August when the FSA identified Northern Rock as a case for concern which could ultimately lead to an issue for the Bank of England, when it did inform us.

**Q66 Mr Breed:** So you would prefer to abolish the joint appointments rather than use the joint appointments as an opportunity for more information exchange to become more aware earlier of any potential problems?
***Mr King:*** I do not think those two positions on the boards of the two organisations are relevant. The Board of the FSA is not there to make judgments on the individual supervision of individual banks, and the Court of the Bank is not there to make decisions on either monetary policy or our role in financial stability in terms of its detail. That is to do with the oversight of the two institutions—the management, the budget, the way in which it is functioning overall. What matters, and what both Callum McCarthy and I have discussed at some length, indeed we have been working on it for long time, is to make sure that the working contacts and that the working levels are really effective, and I think, to be honest, they have been. The Bank has its responsibilities and we sent our reports to the FSA, the FSA has its responsibilities, and when it became clear that Northern Rock could become something relevant to the Bank's responsibilities, then, on 14 August, the FSA informed the Bank. I think that communication did work.

**Q67 Mr Breed:** Thank you very much for that. Can I turn now to accounting principles. To what extent do you think the accounting principles currently used by the banks need to be revisited?
***Mr King:*** I do not think the principles need to be revisited in the sense that the approach of mark to market is actually a sensible one. Of course, if there is no open market and no observable prices, there needs to be something which you can use as a substitute when the market is not open. I think to abandon mark to market and go back to something which really lacks all transparency in terms of valuations would be a retrograde step. I think we have seen that the way in which the banks have made progress in this crisis is actually to be as open as possible about their losses, even if it involves making statements of losses which may well yet turn out not to be losses. After all, the losses that we are seeing revealed by banks do not correspond to cash losses, they are not the failure to pay by people who borrow from the bank, these are marking to market in a situation where the markets are not functioning properly, and it is quite conceivable that in a year's time these prices will have risen, in which case the banks will be marking to market and showing considerable profits again, which will undo some of the losses of this year.

**Q68 Mr Breed:** Is that not the problem: mark to market just exacerbated the whole cycle?

***Mr King:*** Mark to market clearly produces a more cyclical measure of profits—that is undoubtedly true—but it is a lot more transparent than letting the banks have freedom to decide what values to put on things. Then you have really got to be concerned about the transparency of accounts. What matters, I think, is how people respond to the publication of profits and losses based on a mark to market. They should not over interpret or exaggerate the significance of something which can be volatile. All of us interpret and use accounts, but there is something valuable about having accounts drawn up in a way that is based on observable data.

**Q69 Mr Breed:** So how do we get transparency when dealing with off-balance sheet instruments? The whole nature of the thing is that they are transparent.
***Mr King:*** One of the lessons I hope will be learnt is that a large number of off-balance sheet activities and vehicles which were set up in order to engage a regulatory arbitrage should not occur in the future, things should be on balance sheet. It is a rather odd concept really to have on-balance sheet and off-balance sheet. I gather it is practised in areas other than the banking system. Nevertheless, it is not one I see an enormous attraction to.

**Q70 Mr Breed:** Can I end by saying that, from what you are saying about the FSA and the supervision of banks, I seem to recall that when I visited the supervision department and sat in the waiting room of the Bank of England they had a little thing up on the wall which said, "There are no new rules in banking. You just have to relearn them every ten years." Is that something you might recommend the FSA put up in its waiting room in respect of the bankers going there in terms of their supervision?
***Mr King:*** It is something I would certainly recommend that the chief executives of the banks put in their dealing rooms. As I said, we have to remember the lessons of history. We did not at the Bank. Creditanstalt 1931, the provision of lender of last resort led to a retail run; so it has happened before.

**Q71 Chairman:** Governor, I do not want to go over history again, but the issue of financial stability. We have the Deputy Governor of the Bank with responsibility for financial stability on the FSA; indeed he is on the Risk Committee. If you want to clear up a lot of confusion here, there is long way to go on this because the perception is that that was the bridge in financial stability between the Bank of England and the FSA and that bridge was deficient.
***Mr King:*** I do not believe that the right bridge is cross-membership of the governing bodies.

**Q72 Chairman:** So there has to be something else, in other words.
***Mr King:*** I have monthly meetings with Callum McCarthy where we can raise with each other any concerns that we have. John Gieve does the same with his opposite number. A lot of working members of the Bank also do it with people in the FSA. It is that working level contact that matters more than doing it at the level of the overall governing body, which is meant to be the principles of managing the organisation, not the details of any individual cases, where it is very important.

**Q73 Chairman:** I think it is worthy of debate in the future.
***Mr King:*** I think the thing that really will change is both the FSA and the Bank have accepted that we need to be more involved in knowing about individual institutions long before it gets to the point of no return.

**Q74 Mr Love:** Following that up, Governor, of course the problem last August was the way in which the crisis happened very quickly. You are talking about regular monthly meetings. Do you not feel that there needs to be some stronger bridge which the committee has suggested, may be that is not acceptable to you, in order that if a crisis emerges very quickly you can deal with it.
***Mr King:*** I did. Callum McCarthy and I were having almost daily phone calls with immediate affect. I think that regular contact started immediately on 9 August and we started to talk. I do not think the lack of contact is the issue. There were other problems then. As I say, I think many of them would be met by the reforms that your committee has advocated.

**Q75 Mr Love:** I shall not go into that. There was a question earlier when you responded by saying we need to have perspective about the situation of the British economy at the moment, and you talked about growth figures for the first quarter. I think there have also been consumer expenditure figures for the first quarter, which actually look slightly better than perhaps most people expected. What is your perspective about the state of the British economy presently and how optimistic are you looking forward?
***Mr King:*** I do not want to deny that I would expect, as a central view, that there would be a slow down this year and into 2009—that was the central view that the Monetary Policy Committee put forward in its February report, and we will see what we come up with in our May report. It is striking that the retail sales figures were very strong in the first quarter. It is the case that other information on consumer spending was less optimistic, whether it be the surveys or other pieces of data, and I would gradually expect the events of the last few months to have an impact in reducing the growth rate of consumer spending. Remember, this is something that I have been expecting, and, indeed, perhaps hoping for, for some time, a rebalancing of the economy, and I think we would expect over the next two years that there would be some rebalancing of the economy. But that would also be accompanied by a slowing of growth, so the economy would grow below its long-run average for a couple of years. But that is not a disaster in itself, we were growing above the long-run average for a number of years before that, and I think a sense of perspective is required in terms of actually realising that we do not have the

ability to ensure that the economy grows at exactly the same rate year in year out, there are movements up and down from year, but I do not think we should cry doom and gloom. We have to take the problems in the financial sector very seriously and deal with those. I have always said, if we can contain the problems with the financial sector, then the knock-on effects on the rest of the economy will be much smaller, and I still think that is the case.

**Q76 Mr Love:** Turning to the international economy, what role do you think the IMF can play positively at the present time with the current financial crisis?

***Mr King:*** I have been arguing for a number of years that it should see its role less in terms of providing large lending packages to countries and more in terms of providing a clearing house for ideas and thinking and communications, most of all among the major economies. What we have seen very markedly in the last 18 months is the fact that the problems or the developments in the Chinese economy affect enormously other countries in the world and the problems the United States have been facing affect what is happening in China, which has seen quite a significant inflationary surge, which is a problem. So we cannot just solve these problems individually, it is necessary for the major world economies to sit down and talk to each other and, at very least, think through why they have adopted the frameworks that they have. I think the IMF is the only body that can play that role. I think the G7 is not in a position easily to do that now. It does not include China and India. There is no sign that China and India particularly want to joint the G7. What they want to be are still representative of the parts of the world from which they come. They are still emerging markets themselves. What we need, I think, is an international organisation which has legitimacy firmly stamped on it, because every country in the world belongs to it and can use that legitimacy to organise what I hope would be private and informal meetings amongst some of the key groups of countries. One of the things that has gone wrong with the G7 is that it insists on publishing a communiqué at every meeting, which means that the intimate discussions that used to happen in the early days of the G7 and the importance of those discussions in changing people's minds and views no longer apply. People go to the G7 meetings, make clear what they think, make it clear what initiatives they want to announce in order to say that we achieve something in this meeting with a communiqué as a public relations device. It is not an effective body in having serious discussions about the challenges facing the world economy, and that is why I think the United States has focused a great deal in the last year or so on bilateral contacts with China. But then we have seen a massive rise in oil prices and energy prices and actually the primary producers in the world, not just China but the oil producing countries, also matter a great deal in these circumstances. This is where the IMF must come into its own, but to do that it has got to change the way it does surveillance, it has got to make sure that that surveillance is not focused on the details of micro-economic policies of the developed countries but is absolutely focused on the spill-over effects of what is happening in one economy on other economies, and that, I think, is the key to the complaint of many developing countries. They always feel the IMF have tough surveillance on them because they want to borrow money from the IMF but never do tough surveillance on the big developed economies. If the IMF really took this multilateral surveillance seriously, it would find some quite pungent things to say about the developed economies as well, and that would be no bad thing for the IMF. It does have a clear role, but it is mainly, but not exclusively, on its surveillance regime.

**Q77 Mr Love:** I think there are plenty of people that argue about multilateral surveillance, and it needs to be tougher and more objective, but there is still an issue about the confidence of all of the countries to engage with that process, getting the confidence of India and China that the tough messages that they would want to give not only are being given to the United States as well but are given in a way that actually is going to assist everyone in the world economy. How do we achieve that confidence?

***Mr King:*** There are two things. One is leadership. I think Dominique Strauss-Kahn has made a very good start and has shown willingness to exhibit leadership in this area, and I think that will create confidence. He has gone through agreement on both the mission of the Fund, the governance of the Fund and quotas, and also the financing of the Fund, so I think those are big steps forward. He has got to take that forward to make a real success of multilateral surveillance, but I think he is providing the leadership within the Fund to do that. The second, I think, is just a realisation which has been growing amongst all the big countries, the G7 and China and India, that it is in their self-interest to engage in a proper dialogue, and I think that is growing as the problems become more acute.

**Q78 Mr Love:** You talked in your response to the committee about more substantial reform of the IMF. I suspect that was a comment on Dominique Strauss-Kahn's so-called reform so far. What further more radical reform do you suggest is needed in the IMF?

***Mr King:*** We have made big steps. I think the quota changes are at least a first step towards something more substantive. I do not want to exaggerate that, but it is an important symbolic part. Votes do not play a crucial role in the Fund, but they still matter. In some ways what matters even more is the governance of it. I have spoken out before about the internal governance. I think the main shareholders need a more efficient way to hold the IMF management accountable. I think having a full-time resident board in Washington is not a very effective way of doing that. I think it uses up a lot of resources and does not produce anything that really helps the Fund fulfil its main mission. So I will be more radical on those grounds. I have made those points before.

They are not particularly appreciated by the Executive Board or many of those who enjoy the patronage of the Executive Board, but Keynes argued in 1944, 1945, 1946 that we should not have a full-time resident board and I think he was right.

**Q79 John Thurso:** Governor, I would like to ask you about the money market operations, but first can I ask a more general question flowing on from some of the comments that have already been made. We have talked this morning a lot about the FSA and the Bank and the relationships and different responsibilities, and in your questionnaire you talked about the balance of power and responsibility. There is a third member of the tripartite, which is, of course, the Treasury. What would you like to see improved in their performance to make that system fully operational?

***Mr King:*** I think it is rather harsh on them to say what should we like to see improve. Their role is clear, which is that they have to make decisions on the use of public money. They have always done that quickly and efficiently; so I do not think I have any criticism of the way that they have conducted that. I think what is important is that their job primarily is to design a framework. I think that the spirit of what we have learnt over the last nine months is of the following kind. In monetary policy we have a very clear framework for which the Government sets the objectives, sets the framework within which the Bank of England takes the individual decisions. That works extremely well. I do not think we had a framework like that for financial stability. We had the tripartite arrangements. My honest view is that they actually worked, they might have worked better, but what did not work was that we did not have a framework for a special resolution regime for banks and could not deal with failing banks. I think the responsibility of the Treasury is to put that in place and then to step back and let those charged with the responsibility of making that work get on with it.

**Q80 John Thurso:** In your answer to the questionnaire, under market operations, you stated that the primary objective is to implement monetary policy by keeping interest rates on overnight borrowing in the money markets in line with the bank rate set by the MPC. How do you intend to do that and what are your comments on the criticism of the accuracy and credibility of LIBOR that have been raised by the Association of British Bankers?

***Mr King:*** I think those are two rather different issues. On the overnight rate, we designed a new method of money market operations which was described in our Red Book and was put into place well before the onset of the crisis in August. A key part of that framework is allowing banks themselves to determine the size of the reserves they hold at the Bank of England. Many banks have taken the opportunity to change their required reserves in order to give them a greater cushion of liquidity. Indeed, that is the reason why we are the only central bank that has actually injected, in net terms, a significant amount of additional liquidity into the money markets since last August. 42% more liquidity is now injected into the markets than was the case in August. There is no other central bank that increased it anywhere near that scale. I think the money market framework works well, and we have an ability, through the way we have designed those operations, to ensure that the overnight rate does stay very close to the policy rate set by the Monetary Policy Committee, which has to be the first objective of money market operations, to ensure that the decisions of the MPC are mapped into the interest rates which are ruling in financial markets. I think that works well. In terms of LIBOR, that is a rather different question. This is about the rates which banks state they are able to lend to each other, and that reflects, first of all, confidence about the banking system. There is always a small difference between that rate and the expected policy rate—15 to 20 basis points—but since last August the rate shot up, came right down again, went up, came down again and has since shot up for a third time. You can analyse the reasons for that—initially liquidity but now really concerns about credit risk and lack of confidence in the banking system. That, I think, is not something that is amenable to treatment by money market operations. You can certainly, by extending wider liquidity operations, as we did in the Special Liquidity Scheme, hope to have some indirect influence on it, and that is why we introduced the scheme that we did. In the end, that reflects confidence by banks in each other, and that is an important aspect of financial stability which we have been working to try to improve.

**Q81 John Thurso:** The second point that you raised and which you drew to our attention in your note on 12 September was the objective to prevent a major shock to the financial system, but you also went on to say that any funding requires a balancing act and, although it can remove fragility in the financial system, it can also encourage excessive risk-taking in the future. The last time you were before us, in answer to a question I put to you, you talked about the hubris of this issue, which I thought was remarkably apt.

***Mr King:*** Yes.

**Q82 John Thurso:** How can the Bank's operations actually work to curb that hubris when so much of what has been going on seems to have been fuelled by a mixture of greed and testosterone?

***Mr King:*** I do not think there is going to be an issue for the next few years. As I said, I think there is not much hubris around today. The question is how can we stop hubris building up over the next ten, 15 years? I have no simple answer to that, except that we never forget the lessons of this. If you recall, on 12 September I sent you a paper, in advance of our appearance on 20 September, in which I said, "Balancing this need to provide liquidity when there is a threat to the balancing system against the encouragement of future excessive risk-taking is a balancing act which poses considerable challenges and in present circumstances judging that balance is something we do almost daily." I think that balance changed in March, when we felt that the hubris had disappeared. There was a real concern about confidence in the banking system, there were threats to the banking system all over the place, and I decided at that point it was sensible to provide liquidity, but we would have to ensure, through a combination of regulation, speeches, monitoring and, I hope, a change in the culture of what goes on in the financial sector, that we do not return and see a repeat of this hubris and the excessive both lending and also creation of financial instruments that, in the end, as I said at the speech I made at Mansion House last year, turned out to be flat when you looked at it, whatever it said on the bottle.

**Q83 John Thurso:** Moving from subprime to sublime, can I ask you about Scottish bank notes?
***Mr King:*** Yes; absolutely. Scottish and Northern Irish.

**Q84 John Thurso:** Indeed, although it is the Scottish ones I am particularly worried about. The Banking Reform Consultation proposes new arrangements, but there has been a lot of discussion north of the border about the threat to our cherished and valued bank notes. Can you use this occasion to reassure me, and all those who like our Scottish bank notes, that they are not under threat?
***Mr King:*** I certainly can. Not only is there no threat, but the proposals in the legislation are designed to make it even safer and more secure to hold Scottish and Northern Irish bank notes. It does two things: one is it makes sure that the banks that issue these notes do actually hold Bank of England notes to back them so that the seigniorage on those notes does accrue to the UK taxpayer, as it was always intended it should, but perhaps even more importantly, it ensures that because this holding of Bank of England notes backing the issue of Scottish and Northern Irish notes is ring fenced, there is complete security for people holding Scottish and Northern Irish bank notes, which there is not at present. This legislation would ensure that there was complete security for anyone holding those notes, and that will ensure, I think, the continuing issuance of those notes.

**Q85 Chairman:** Governor, the First Minister of Scotland says that the changes were the greatest threats to Scottish notes since 1845.
***Mr King:*** I do not agree with him.

**Q86 Chairman:** But it is an underhanded and shabby attempt to cloak it in a document about financial stability, and it is a dagger at the heart of Scottish bank notes. So, there is no such thing as a dagger here at all?
***Mr King:*** It is far from being a dagger. This is intended to ensure the continued issuance, safely, of those notes if the banks that issue them wish to continue to issue them.
**Chairman:** Thank you. That is a reassuring comment that John and I will take back to Scotland this week, Governor.

**Q87 Mr Mudie:** I thought you were unfairly dismissive of my colleague, Mr Fallon, when he asked why you had not put any, other than financial conditions, on the facility.
***Mr King:*** I am sorry, I did not catch that. Why we had—

**Q88 Mr Mudie:**—had not put any, other than financial conditions, on the special facility. Did you consider any other facility? Michael raised the quite straightforward matter about shareholders contributing; he raised the question of the housing situation for existing borrowers, not future borrowers, on two-year loans that are coming to an end this year. Why did you hand to the very people who caused this problem £50-100 billion without any conditions?
***Mr King:*** We imposed a lot of conditions. We did not hand £50 billion to anybody. We said we would swap securities.

**Q89 Mr Mudie:** That is financial conditions. I am excluding those. Those are in the public domain. The conditions that Mr Fallon raised and I am raising: why were they never discussed?
***Mr King:*** One obvious reason for the Bank of England is that we have absolutely no powers whatsoever to impose any of those conditions.

**Q90 Mr Mudie:** You may not have the statutory power, but if you are lending somebody £50 billion, I think you are in a very powerful position to negotiate a deal. It is the sort of deal that you failed to negotiate with Northern Rock. I cannot understand why you are so unwilling to use your powers. If I was lending somebody £50 billion, I think I would get some agreement on some things that I would like in the wider picture.
***Mr King:*** I think that is part of the problem, because this was a central banking operation which I think would have failed if it had been thought that there were hidden political agendas attached to it. This is a central banking operation, which is similar in kind to the operations that the Federal Reserve did in March when it extended two large facilities. They did not impose any conditions of that kind. The ECB has not imposed conditions of this kind through its normal money market operations, and I think it would be improper to do that for an operation of this kind. This is designed to restore confidence in the banking system, not to regenerate any aspect of the mortgage market or to achieve anything else. The question I think Mr Fallon did raise was about capital raising. That is much more relevant to the question of restoring confidence in the banking system and, as I said, and I have said before, I felt it was important that banks did raise capital. I have made that point publicly before you in December first, then in a speech in January and I have raised it privately with the FSA, and I am glad to say that banks are raising capital, but I do not think that we at the bank are in a good position to judge precisely how much capital is raised, nor who in fact should raise it: because it is not true that all banks need to raise capital—some do and some do

not—but I think the market pressure now to do so is quite strong. So I think we have achieved our objectives.

**Q91 Mr Mudie:** But there are two million people with loans which finish this year who would have liked to be included in your objectives and been able to continue, maybe not at the same rate, with a mortgage, and some of them are facing not continuing with a mortgage.
***Mr King:*** No, but I rather doubt that people who took on a fixed-rate mortgage two years ago could have had any reasonable expectation that they would be guaranteed the same rate after two years.

**Q92 Mr Mudie:** You sound, Mr King, like a man who sings in his bath. They are only losing their house!
***Mr King:*** I am not. I am just not in favour of attaching political objectives to a central banking operation.

**Q93 Mr Mudie:** The last time I saw you, you were not very forth coming on the *Sunday Times* journalist who wrote about you. This week's *Sunday Times* suggests, "There is a number of unofficial conditions imposed on the banking industry in exchange for the bail-out", to quote the *Sunday Times*. Are there informal, unofficial conditions being imposed?
***Mr King:*** No.

**Q94 Mr Mudie:** Absolutely not?
***Mr King:*** There are no conditions.

**Q95 Mr Mudie:** So this is totally wrong?
***Mr King:*** Yes, and it is not a bail-out either, so it is wrong in every respect.

**Q96 Mr Mudie:** Okay. Are the full details of the facility going to be made public?
***Mr King:*** They have been.

**Q97 Mr Mudie:** So they are all out in the—
***Mr King:*** Yes, there is a market notice which was put out on the morning when the scheme was issued—we can send you a copy if you would like, but it is on our website—a Special Liquidity Scheme market notice, and that details all the details.

**Q98 Mr Mudie:** So there are no other understandings, agreement, however formal or informal.
***Mr King:*** No.

**Q99 Mr Mudie:** When you designed the facility why did you only include the banks and the larger building societies and not the smaller?
***Mr King:*** We designed a scheme to be one that we could operate with our normal market operations, and so all banks eligible for our standing facilities were eligible, and that remains the case. About one half of building societies are eligible for the scheme and the other half not: they are much smaller. There are two ways in which we think that that is perfectly sensible. One is that, by tradition, they have been able to access their liquidity by going to other building societies and banks bigger than themselves and, secondly, the very small building societies do not have the problems which some of the bigger institutions have. They have not been involved in securitising mortgages, they are not facing the same problem, but if they need liquidity, then they can go to their—

**Q100 Mr Mudie:** This same article says you were encouraging the banks to do exactly that, and the building societies, so it is true in that respect.
***Mr King:*** It is not true that I have encouraged any banks to do anything except consider accessing the scheme, but I have not put any pressure on any bank to lend to anyone else.

**Q101 Mr Mudie:** I understand the need for some correction in the housing market, but I think we are all united in hoping that correction is in the right direction but gentle and harms the fewest people?
***Mr King:*** Yes.

**Q102 Mr Mudie:** But in the whole design of this facility you seem to be fairly clear that you do not necessarily see it operating across into the housing mainstream.
***Mr King:*** No, I think it will link to the housing mainstream. What I wanted to be clear about, given that there was some potential confusion at the time, as well illustrated by some of the articles that you quoted from, was what the purpose of the scheme was. The purpose of the scheme was not in and of itself to try to deal with particular issues in the housing market. If the scheme is successful in restoring confidence in the banking sector, then it will have an impact on conditions in the mortgage market generally across the board. What we do not want to do is to be seen to be taking any measures that alter the relative rates of return on different kinds of mortgages or to encourage lenders to keep lending at 100% loan to value ratios, or whatever. That is what I mean by not getting involved in the structure of the mortgage market. But, of course, when setting interest rates we take into account what is happening in all lending markets in deciding what is the appropriate level of the official bank rate that we set. So, we too do not want to see drastic changes in the economy, we want a slow, steady adjustment of the kind that you agreed we need, and we can use both this Special Liquidity Scheme and the level of bank rate to try to ensure that.

**Q103 Mr Mudie:** Earlier you said the scheme had been discussed and agreed between you and the Chancellor. The *Financial Times* pointed out, when the scheme was announced, the difference in view from your comments and the Chancellor's comments. The Chancellor specifically said " . . . and in turn support the provision of new mortgage lending", and you specifically said that would not happen.

***Mr King:*** No, what I said was the aim of the scheme was not itself to do with the mortgage market, the aim of the scheme was to restore confidence in the banking system. If the scheme works, then it will have an effect on the mortgage market indirectly, but it was not designed to intervene directly into the mortgage market.

**Q104 Mr Mudie:** But the Chancellor—
***Mr King:*** You should ask him what he said.

**Q105 Mr Mudie:** You discussed it. You surely reached agreement and, as is usual with this, your press releases should be co-ordinated. You never got into that extent of discussion?
***Mr King:*** I do not think the Treasury put out a press release that contained those words. We did co-ordinate the reasons for the scheme, we agreed on it, and the line we put out on Monday morning was exactly that.

**Q106 Mr Mudie:** I see you are strengthening your press, so perhaps that will improve things with relationships with the Treasury. My colleague, Mr Viggers, mentioned you as being somewhat Delphic, and you said, "I am never Delphic." In the same *Financial Times* article you said—
***Mr King:*** Perhaps you should broaden your reading. *Natural History* might tell you more.

**Q107 Mr Mudie:**—"The objective is not to protect the banks but to protect the public from the banks."
***Mr King:*** That is what I have been saying to you this morning.

**Q108 Mr Mudie:** Go on; spell it out.
***Mr King:*** I will spell it out. The aim here is not to—. There is no bail-out here, we are not doing this because we have an interest in the financial position of the banks as such, but because we are concerned about the position of the banks on their ability to finance growth in the rest of the economy. It is the rest of the economy that is the ultimate objective here, not the financial sector as such.

**Q109 Mr Mudie:** It would be more acceptable if you had actually included in the agreement some nod in the direction of the real economy, rather than just easing financial pressure on the banks and the financial sector?
***Mr King:*** I think that would have been a PR gesture and it would have been worthless.

**Q110 Mr Mudie:** It would have been much appreciated.
***Mr King:*** Maybe you appreciate PR gestures, but I do not. What matters is the impact of the scheme on the economy. That is what matters and that is what we are doing. It is a central bank operation.

**Q111 Jim Cousins:** Governor, what has dominated a lot of our conversation this morning is these very difficult judgments about liquidity and the need for corrective action. You have, as I see it, perfectly fairly said that you cannot measure your capacity to do that by the armies of people that you deploy but by their quality, and you have referred to the strength of the younger members of your team who are involved in these issues even though there is only about 120 of them, if I have recollected your comments about this. But, of course, the decisions will not be taken by those younger people, whatever their quality, they will be taken higher up the line. Do you think there is sufficient authority and that the markets recognise sufficient authority in the judgments of those people higher up the line?
***Mr King:*** If you are referring to me, I think you should make that judgment. I do not think I can make that judgment on myself easily.

**Q112 Jim Cousins:** Absolutely correct. It was not you that I was referring to.
***Mr King:*** It was the team.

**Q113 Jim Cousins:** Yes?
***Mr King:*** I have full confidence. I have a supportive and loyal team of excellent people, and I think we have a great deal of expertise. The 120 people that you mention are in the financial stability part of the bank, there are some very talented younger people there, but outside that we have another team in the markets area of the bank which I think has a very well respected market intelligence function that I set up. In fact on day one when I was Governor, I said to Paul Tucker, "I want you to create a new market intelligence function". That is highly respected in the markets and has a lot of information that it makes available and feeds into all our decisions on this. Then we have the banking department under Andrew Bailey, which I think is highly respected for the way it conducts its banking operations. My judgment, and, of course, it can only be a judgment, people may disagree with it, is that we do have a lot of expertise on which we can draw.

**Q114 Jim Cousins:** In the questionnaire that we asked you to provide for us you said at one point, "I am determined that the Bank should accept new obligations only if it is granted sufficient powers to meet them." How would we know whether you thought that you had not been granted sufficient powers?
***Mr King:*** You would ask me, and I would come and tell you. I would not be willing to accept obligations placed on the Bank without the ability to have the powers to meet those obligations, and I would make that quite clear in public.

**Q115 Jim Cousins:** But you would not wait for us to ask you?
***Mr King:*** Probably not, but it would depend on the timing of various things. If it was the day after the obligations had been placed on us and I came to you, I would tell you. We would certainly want to make this clear in public, yes.

**Q116 Jim Cousins:** One of the points that you have made to us this morning is that you felt that in March over-confident pride in judgments and practices disappeared in March 2008, this year.

Governor, do you not think there is an issue too about your own over-confident pride in your judgments, and has that now disappeared?
***Mr King:*** I think that is something that you can form a judgment on. I have not changed my view about what I did in the past. I would do the same things again, apart from two issues: (1) the failure to communicate any of this and (2) the failure to press early enough for a guarantee to be announced when the lender of last resort operation for Northern Rock was implemented. Those are the two things I would look back on and say we should have done differently, but I would not have taken different decisions in respect of the market operations or other actions that we took as a bank.

**Q117 Jim Cousins:** You have just now told us in the last few minutes that you do not believe it would be right to attach political objectives to central banking operations?
***Mr King:*** By the central bank. Clearly if the Government wishes to intervene in some way, it has the authority to do so, but I think it should not then pretend it is a central bank operation. The Government always has the freedom to take action, and it would do so for political reasons, clearly.

**Q118 Jim Cousins:** You have made a point already this morning about the importance of intellectual leadership. The situation facing us is not that of a university seminar. Do you think it is wholly realistic to say that political objectives, in the broadest and best sense, and central banking operations can be distinguished in the way that you sought to tell us?
***Mr King:*** I think it is very important that they are, because people look at what the central bank does and say, "Why have you done this? Can you give us a good central banking reason for having done it?" The judgment we were called upon to make, the judgment I referred to in the 12 September memorandum I sent to you, was a balancing judgment between the risks to the banking system as a whole on the one hand, immediate risks, and the danger of encouraging excessive risk-taking in the future. That is not a political judgment, that is an economic judgment, and I think people look to the Governor for that economic judgment. Other people can form the political judgments, and I am not saying that a central bank judgment necessarily overrides everything else. The whole point is to design frameworks which provide an appropriate input for the political judgment but a very clear definition of what the central bank should be doing and the central bank should not be straying into the political arena. I think in the monetary policy areas we have got that exactly right.

**Q119 Jim Cousins:** Do you think the Court of the Bank—it will be smaller in future—has any role in exercising scrutiny of your own strategic judgment?
***Mr King:*** It does so in all areas. It does not in terms of the setting of interest rates, but it certainly does already in terms of how we manage monetary policy work in the Bank and how the MPC as a whole functions. It has an important role there and it also has, equally, that in financial stability, yes.

**Q120 Chairman:** Thank you, Jim. Governor, I have got a few questions to ask at the end. The Special Liquidity Scheme states that for mortgages and credit cards only triple-A backed bonds will be accepted. Given the stated failings of the rating agencies, why should we trust their word in such operations?
***Mr King:*** I think the real weaknesses with the ratings applied less to these more standard instruments and more to the very complex products. It is the CDOs and the infamous CDO squared and instruments of that kind where people lost confidence in the judgment of the rating agencies and the mixture of different instruments, the tranches that were mixed to give a bundle that were then given a triple-A rating, not so much the rating of the standard instruments which is used by all central banks in their market operations.

**Q121 Chairman:** Do you agree with the principle that in any new system creative tension would be required between the bank and the FSA?
***Mr King:*** If it is creative, yes. If it is not, no.

**Q122 Chairman:** That is good. To add to Jim's question, what further criteria would you use to determine whether the Government has given you sufficient powers to accomplish any new financial stability responsibilities that you have been given?
***Mr King:*** I would want to be convinced that the powers we had did give us a real chance of being able to meet those responsibilities and to be answerable for them. I think, without knowing what those powers are, it is very hard to define the financial stability objective of the Bank, and so what I would say is: tell us what the powers are and then we can tell you what we are capable of achieving.

**Q123 Chairman:** To add to the questions that have been asked before, what changes would you like in the FSA to ensure that it gathers information that the Bank can use to respond to rapidly emerging problems in the commercial banks?
***Mr King:*** I think the FSA and the Bank have already agreed that we need change in this area, and it is a question of ensuring that requests from the Bank have real force and are automatically included in the questionnaires sent to banks. I think we have to be very careful not to put too big a reporting burden on them. This is a question of not having dual reporting requirements but actually consolidating it through the FSA—people are at work doing that now. It would give us for the first time the right to say: we

must have information on certain issues, of which liquidity was the key one in the autumn, not for that request to be quietly ignored.

**Q124 Chairman:** Would the joint position proposed by this committee with the Deputy Governor for Financial Stability, drawing the staff from both the Bank and the FSA, be worthy of serious consideration?
***Mr King:*** Yes. I think the basic argument is that we need a special resolution regime. I think you argue, correctly, in my view, that it should not be with the supervisor but with a different body. I think you can argue plausibly that it should be with an independent body, it could be with the Bank. Yours is a kind of quasi independent. I am not quite sure how it would work with a deputy governor partly responsible to me on some things but not on others. I think, if you were to go down that route, there would be quite a strong case for not having that deputy governor on the Monetary Policy Committee. Certainly it is worthy of serious consideration and it is only some of the details of it that may need thinking through, but I think that sort of major reform is required. I very much hope that, instead of seeing a few minor changes in legislation, we will actually see something serious of that kind, because what happened last autumn was unacceptable.

**Q125 Chairman:** One last question for you. How would you wish your performance over the whole of your second term to be assessed and judged by those outside the Bank?
***Mr King:*** I think in two main ways. First, I would like people to recognise, as I hope will be the case, that we have got pretty close to meeting the inflation target and done all we can reasonably in the circumstances to have set interest rates to meet the inflation target, that that regime remained credible, despite the disturbances that we have been discussing in terms of higher energy and food prices, that we have a monetary regime that works and, secondly, I think that I have left behind a framework for the committee, for the Bank as a whole and particularly the younger people in the Bank coming through, to take over and that people would feel that the change was seamless and that they would not notice any difference at all when I left.

**Q126 Chairman:** Governor, you have been very generous with your time with us. Can we wish you every success in your new term. We look forward to you coming back and answering our questions in a non-Delphic way, as you have done in the past couple of hours.
***Mr King:*** I will do my best to avoid being Delphic. Thank you very much.

# Written evidence

**Treasury Committee Questionnaire: Response from Mervyn King, Governor of the Bank of England**

## Management and Governance

1. *What reforms of the Bank of England have you instituted during your first term as Governor and what has been the purpose of those reforms?*

When I became Governor, I submitted to the Court of the Bank a paper entitled *The Bank of England: the next five years*. Its first paragraph read:

"My vision for the Bank is that it should be focussed on promoting monetary and financial stability in the United Kingdom. It should play an active role in the international monetary and financial community. But it should not take on additional responsibilities which are outside the remit of the 1998 Act and Memorandum of Understanding. Its work should be seen as a hallmark of excellence". I went on to say that, "there are three main challenges that will confront the Bank over the next five years. First, keeping inflation on track to meet the target during a period of re-balancing of the UK economy. Second, focussing the work of the Financial Stability area of the Bank in order to make it more operational. Third, building a culture of even greater professionalism in the Central Services areas of the Bank".

Given those objectives, we initiated a fundamental review of the Bank's strategy. As a result, a number of significant reforms were made to the way the Bank works. The core purposes of the Bank were reduced from three to two, covering the promotion of both monetary and financial stability. And to implement the strategy, one of my first steps as Governor was to reform the internal management of the Bank, creating a single Executive Team.

On the monetary stability side, we have managed to keep inflation on track to meet the target, notwithstanding the large external shocks of the past year or so. Since 1997, the target rate of inflation has averaged within 0.1 percentage points of the target itself. Although the arrangements for analytical support of the MPC have remained largely as they were, significant reforms were made to the Bank's money market operations. The objectives of those reforms were to keep overnight interest rates in money markets as close to Bank Rate as possible, in an efficient, simple and flexible way. The changes have transformed our ability to implement monetary policy on a day-to-day basis. I am also pleased to have had the new system in place ahead of the recent financial turmoil. Banks have been able to increase the reserves they hold with us because they are able to alter their target levels of reserves once a month. And these balances have increased by 42% since the start of last August.

On the financial stability side, we instituted a re-organisation of the Bank's Financial Stability area. The objective was to make the area more operational. Its work is now focussed on four issues: risk assessment; risk reduction; the oversight of payments systems, and crisis management. To supplement that, the Bank has created a market intelligence function. We have since 2004 built a large network of contacts in global financial markets, which has been a valuable source of intelligence, especially during the current financial turmoil. We have also launched a new-style Financial Stability Report to sharpen our communication of the key risks to financial stability.

A new Memorandum of Understanding between HMT, FSA and the Bank was agreed in 2006. The revised Memorandum replaced the statement that the Bank was "responsible for the overall stability of the financial system" by a description of the four ways in which the Bank contributes to financial stability: by ensuring the stability of the monetary system; by overseeing those parts of the financial system's infrastructure that may affect the stability of the UK financial system; by maintaining a broad overview of the UK financial system as a whole; and by undertaking, in exceptional circumstances, official financing operations. The main reason for the change was the mismatch between the responsibilities attributed to the Bank and the powers (or lack of them) given to the Bank to enable it to discharge those responsibilities. We will need to consider the case for further revisions in the light of the outcome of the consultation process on banking legislation which is underway and on which the Treasury Committee has expressed its views.

In the Central Services parts of the Bank, we have continued to reduce costs while enhancing the quality of the service provided by making external appointments to the positions of Finance Director, HR Director and Head of the Legal Unit.

All of these changes to the Bank were designed to ensure that we could meet our objectives. At the same time, a key feature of the strategy has been to ensure that everything we do flows from our two core purposes of promoting monetary and financial stability. The Bank has, for example, withdrawn from banking activities that do not contribute to them.

This greater focus has allowed us to improve our ability to pursue the two core purposes and, at the same time, keep spending on our policy functions broadly constant in money terms. The Government has been able to propose a reduction in the proportion of deposits that banks have to hold with the Bank as Cash Ratio Deposits from 0.15% of eligible assets to 0.11%.

2. *What do you regard as the main challenges you will face as Governor of the Bank of England during the next five years?*

The Bank is likely to face major challenges in relation to both monetary and financial stability.

The Monetary Policy Committee faces the challenge of keeping inflation close to the 2% target. That is unlikely to be straightforward. When I became Governor in 2003, I referred to our economic performance over the previous ten years as the nice (non-inflationary, consistently expansionary) decade. But in the past two years we have seen that changes in the rest of the world—such as a sharp rise in oil and other energy prices—can push inflation materially away from the target. The MPC will need to ensure that these deviations are temporary so that they have minimal impact on the expectations of those setting pay and prices. This will not be the last time it faces a balancing act between avoiding unnecessary volatility in economic activity and avoiding any tendency for deviations of inflation from the target to persist.

In the area of financial stability, the immediate challenge will be to ensure that the necessary adjustment in the financial sector does not result in a loss of confidence in financial markets and the banking system. The financial sector is reducing the size of balance sheets by cutting back on lending and raising new capital. That is not a process we can, or should try to, stop. By ensuring that banks can access liquidity, the new Special Liquidity Scheme will support confidence during this period of adjustment.

The second challenge in the area of financial stability will be to embed in our institutional structure the lessons from the recent financial turmoil. We are reviewing our framework for market operations. In addition, the Government will decide, in the light of the response to the Consultation Document published in January and the Treasury Committee's own Report, what responsibilities the Bank will have in this area. I am determined that the Bank should accept new obligations only if it is granted sufficient powers to meet them.

3. *How do you think the Court of the Bank of England has operated during your first term and how do you expect its role to change during your second term?*

Court's role, as set out in the 1998 Act, is to "manage the Bank's affairs, other than the formulation of monetary policy" and to "ensure the effective discharge of the Bank's functions." When I became Governor, Court meetings were restructured to focus on the management of the Bank and, as far as possible given the constraints of the 1998 Act, have been conducted in the Committee of non-executive directors under the chairmanship of the senior non-executive director. The objective was to make Court's discussions more focussed and to introduce effective challenge by non-executive directors.

In my view Court has fulfilled its role very effectively. It supported the implementation of my 2003 strategy by translating it into a concrete business plan with clear priorities and by holding the executive to account for delivery of them. Through its oversight of the Bank's budget, Court has ensured value for money. And it has helped resolve difficult management challenges. To give one example, Court played a key role in the review of the Bank's pension scheme. It defined both an upper limit for the share of the pay bill spent on pensions and the timeframe over which the Bank had to meet that target. Between 2006 and 2007, Court discussed the issue six times and the Bank introduced a new pension scheme for new entrants in October 2007.

Looking forward, the Government intends to amend the provisions governing the size and composition of Court. Its proposals in this area are, I believe, sensible.

In the recent consultation document, the Government stressed the role of Court in overseeing the Bank's work in financial stability. Court already has this responsibility and agreed last December to a revised framework for its oversight of the Bank's work in this area. At its most recent meeting, Court agreed to review that framework once the questions about the Bank's future role in financial stability have been resolved. That is an entirely sensible conclusion. Of course, we need to avoid potential conflicts of interest.

## Interest Rate Decisions and Economic Policy

4. *How have you worked to combat the uncertainty around the economic outlook over recent times?*

Uncertainty about the outlook is a natural feature of the economic landscape. It is important for the MPC to be open about the fact that we do not know precisely how the economy will evolve. Our aim is not to add to that uncertainty by setting interest rates in an unsystematic way. In times of heightened uncertainty, it is important that people can have confidence in what the MPC is doing and that, although inflation may move away from the 2% target temporarily, we will return inflation to the target.

Setting Bank Rate to meet the inflation target is not straightforward when the outlook is so uncertain. The job of the MPC is to focus on the full range of evidence available to us. As well as the official data and surveys from business organisations, that includes reports from our Agents around the country, who talk to their 8,000 business contacts, the surveys which the Bank conducts on its own account, including the recently launched Credit Conditions Survey, and the information we pick up from our own visits around the country.

It is crucial that we do not have a fixed plan for Bank Rate but that we are prepared each month to respond as the data unfold. We need to explain clearly the actions we take and what we are trying to achieve. There are many ways in which we are held accountable. This will be my fifth appearance before the Treasury Committee since the onset of the financial turmoil. I have held two Inflation Report press conferences, delivered two major speeches—in Belfast and Bristol—and given many "off-the-record" talks, both in and outside London, including to business groups, trade associations, Members of Parliament and students. On these occasions, I try to explain two things: the nature of the economic challenges we face, and what the Monetary Policy Committee is aiming to achieve when it sets Bank Rate. Every member of the Monetary Policy Committee has a similar speaking programme.

As I set out in my speech in Bristol, the MPC faces a difficult balancing act at present. We must balance the risk of a sharp slowing in activity this year, which would pull inflation below target next year, against the risk that without some slowing in the pace of activity, above-target inflation in the short term might have some tendency to persist.

5. *To what extent do you think that the current turmoil in financial markets will affect business investment?*

There are three ways in which the financial turmoil is likely to affect business investment. First, uncertainty about the prospects for demand growth is likely to lead companies to postpone investment projects. The Bank's Regional Agents reported in April that investment intentions had fallen across most industries and that much of that stemmed from uncertainty about the impact of financial market events.

Second, the closure of markets in asset-backed securities has left the banking system with an overhang of assets on its balance sheet. Banks have responded to this overhang by seeking to cut back the growth rate of new lending to both companies and households. The Bank's most recent survey of credit conditions showed that lenders had tightened the supply of credit to companies in the first three months of the year and that they expected this tightening to continue.

The third channel through which the financial turmoil will affect business investment is through commercial property prices. Around one third of business investment spending is on buildings and has been supported by strong demand for commercial property—evident in rising prices. But since June, demand for commercial property has eased and prices have fallen by over 10%, reducing the incentive to invest.

These developments are likely to bear down on investment spending, although our central projection is for the growth rate of business investment to slow only a little more sharply than overall economic activity in the near term before recovering a little in 2009. This is because a number of factors continue to support investment. There still seems to be fairly solid growth in the economy outside the energy-related sectors. The net rate of return on capital employed in the private non-financial sector is high. And many companies will be able to use retained earnings, rather than borrowing from banks, to finance new investment.

6. *When considering the UK economy, how much emphasis do you place on the international economic environment? How concerned are you about global imbalances?*

Developments in the world economy can be crucial for the outlook for an open economy like that of the United Kingdom. So I—like all MPC members—place great weight on assessing developments in the world economy. But we cannot simply assume that fluctuations in world activity will go hand in hand with fluctuations in output at home. In 2005, strong growth in the world economy was one factor behind the slowdown in the United Kingdom. Rapid expansion of the world economy pushed up commodity and energy prices, which slowed the growth of real incomes and hence consumer spending.

The credit crunch has, as I explained in my speech in Belfast last October, its origins in the imbalances that had built up in the world economy. What Ben Bernanke, Chairman of the US Federal Reserve, has described as a "glut" of savings, first from Asia, and more recently from oil-producing nations, has driven down real interest rates in world capital markets. Those low interest rates have, in the West, encouraged borrowing and generated large trade deficits. They also encouraged some investors, who were slow to adjust to the new reality of lower returns, to embark on a "search for yield" by purchasing risky assets without stopping to question whether the assets were too expensive.

The re-pricing of risk to a more sustainable level that is now underway is likely to be accompanied by some unwinding of global imbalances. In the UK, our national saving rate is likely to rise. But the imbalances are unlikely to unwind fully as long as the supply of savings to world capital markets remains strong. The difficulties evident in the current, partial, adjustment should make us all concerned about how the imbalances will eventually unwind. If the "glut" of savings on world capital markets were to be withdrawn abruptly as the Asian and oil-producing economies spend more of their incomes, we could see further sharp movements in asset prices and real exchange rates. So I remain concerned about global imbalances.

7. *To what extent do you think that consumers have been affected by the recent disturbances in financial markets?*

The disturbances in financial markets and associated overhang of assets on banks' balance sheets have led to a tightening in the supply of credit from the banking system to households. The Bank's Credit Conditions Survey showed that lenders have been tightening conditions, particularly for secured lending, and intend to do so further. The most significant impact has, to date, been on the housing market, where the tightening of credit conditions has affected those renewing or taking out new mortgages.

The tightening in conditions for new borrowers is likely to generate a fall in the ratio of house prices to earnings over the next few years. Indeed, over the first three months of this year, the major lenders reported that house prices fell. That will have some impact on consumer borrowing and saving, which coupled with only weak growth of real take-home pay as energy and food prices rise, will slow the growth rate of consumer spending this year, possible quite sharply.

There is some tentative evidence that consumers have already reacted to these developments. In the final quarter of 2007, the growth rate of consumer spending, particularly on durable goods, did slow. Measures of consumer confidence have fallen sharply this year. And surveys suggest that retail spending has slowed, although not yet as far as it did in 2005. Official retail sales data, however, showed surprisingly strong growth in the first quarter. It is too soon to conclude that the disturbances in financial markets have had a clear impact on consumers. But I expect to see some slowing in the official reports of consumer spending over the coming months.

## Financial Stability

8. *In your first term of office, what reforms have you undertaken to the Financial Stability section of the Bank of England and what has been the purpose of those reforms?*

See my response to question 1.

9. *In view of the proposals in Chapter 6 of Financial stability and depositor protection: strengthening the framework, how do you see the work of the Bank of England in the area of financial stability developing during your second term?*

The answer to this question will depend on decisions by Government. The Bank's financial stability work is likely to change most if it is given responsibility for the new special resolution regime for banks, along the lines, for example, of the proposals of the Treasury Committee. Once the Government has made its decisions, the Bank will make the necessary changes to its financial stability function to discharge whatever responsibilities it is given. But whatever model is adopted we will make a number of changes. I would highlight four.

First, a lesson from Northern Rock is that the Bank needs to be directly involved with a bank for which a support operation may be necessary prior to giving that support. That points to adopting a model of graduated Bank involvement. In periods of calm, when financial stability risks are low, the FSA would be responsible for prudential discussions with banks. In periods of heightened stress the Bank would join the FSA in engaging with vulnerable banks. Finally, in periods of severe stress, in which support had been, or was about to be, provided, the Bank of England would take the lead with the bank(s) in question.

Second, we need to strengthen the connection between system-wide risk analysis and the outlook for individual banks. And we need to communicate our analysis of the risks more sharply. It is no good identifying the right risks if no one responds to that analysis.

Third, the Bank will need to adapt its crisis management planning to take account of the new resolution regime. This will be necessary regardless of which body is given responsibility for implementing the regime.

Fourth, I intend the Bank to contribute to the design of regulatory and incentive structures for the financial system, to try to curb the excessive build-up of risk-taking and credit creation which was seen ahead of the recent crisis.

10. *Do you foresee the Financial Stability section of the Bank of England requiring additional resources to undertake its work, bearing in mind the likely additional responsibilities and the more unsettled nature of international financial markets?*

We have reallocated existing resources within the Bank to cope with the present financial turmoil. But it is too soon to speculate about the resources that will be required in the longer term until the Bank's responsibilities are agreed.

11. *What personal role will you undertake with regard to the work to be conducted in the Financial Stability area?*

As Governor, I represent the Bank in discussions between the tripartite principals. Under the Memorandum of Understanding I have responsibility for advising the Chancellor about the case for exceptional support operations. Internationally I represent the Bank at the bi-monthly meetings of central bank governors in Basel, which often discuss cross-border financial stability issues, and along with the Chancellor, I represent the UK at G-7, G-20 and IMFC discussions. I also have regular meetings with representatives from the private sector.

Within the Bank, I am a member of the Bank's Financial Stability Board. Through that, I will contribute directly to strengthening our analysis of the implications for individual banks of system-wide risks. And together with my colleagues I will sharpen the communication of our financial stability messages. In June, I will be speaking at the British Bankers Association annual banking conference on financial stability issues. I intend to keep under review the case for further speeches on this topic in light of market conditions and changes to the structure of financial stability oversight in the UK.

### Bank Notes

12. *What do you see as the priorities for the Bank of England in relation to note issuance during your next term?*

I have two objectives for our note issuance work: to maintain confidence in the integrity of Bank of England notes; and to ensure that people can at all times obtain the notes they want.

Anti-counterfeiting measures are crucial if we are to maintain confidence in our notes, so my first priority is to ensure that our notes contain the most effective security features. Our new £20 note contains many new security features. Since its introduction, the total value of counterfeit notes discovered has fallen by around a quarter. We will introduce further anti-counterfeiting measures as necessary. The London Olympics also present a challenge. We need to ensure that they do not become an opportunity for counterfeiters to exploit the large influx of visitors who are unfamiliar with our notes. We are working closely with the police and the Serious Organised Crime Agency to combat all attempts to counterfeit our notes.

To allow people to get the good-quality notes they want, the Bank is focussed on ensuring efficient and robust processes for the distribution of cash. My priority in this area is to get more £5 notes into circulation. I raised this issue in my speech in June 2007 at the Mansion House. Since then, the value of £5 notes in circulation has risen by 15%. We have written to the cash distribution industry setting out the Bank's objective and seeking agreement on ways in which that objective can be achieved. I want to see progress this year.

There are two other areas in which the Bank is working. First, following the robbery at the Loomis cash centre at Tonbridge in early 2006, the Bank has orchestrated an extensive programme of work to make sure that the network of private cash centres across the country has robust defences. Improvements to security have been made, but there is more to do.

Second, the Banking Reform Consultation document proposes reform to the arrangements for protecting holders of notes issued by banks in Scotland and Northern Ireland. These proposals are not intended to end the practice of banks issuing notes, but to ensure that their notes are covered at all times with risk free assets and, in doing so, to ensure that holders of these notes are themselves fully protected.

### Market Operations

13. *What principles should underpin further reforms of the Bank of England's money market operations in the light of recent events?*

As I told the Treasury Committee in December, the Bank is now reviewing its money market operations. In due course we shall publish a revised *Red Book*, which describes our system. I believe that three key principles should underpin any reforms:

First, the primary objective of our market operations is to implement monetary policy by keeping interest rates on overnight borrowing in the money markets in line with Bank Rate set by the MPC. Our framework must deliver this in normal and stressed conditions alike.

Second, as I explained to the Treasury Committee in my note of 12 September, there are circumstances in which it is necessary for banks to be able to access funding from the central bank to prevent a major shock to the financial system as a whole. But any such funding requires a balancing act. Although it can remove fragility in the financial system, it can also encourage excessive risk-taking in the future.

Third, central bank operations tackle issues of liquidity. They do not tackle issues of solvency. They should not insulate banks from the risk of losses on the loans they have made and the risk to the public sector from these operations should be minimised.

The Special Liquidity Scheme, launched on Monday 21 April, is a temporary measure designed to deal with the current problems. It does, however, embody these principles and in reforms to our market operations, we will build on the lessons we learn from the Scheme.

International Role

14. *During your next term in office, what are your priorities for your work within the IMF?*

I have spent considerable time during my first term pressing the case for reform of the IMF. I am delighted that the IMF has started to reform itself along the lines I have been proposing. The first challenge in my next term will be to encourage the IMF to convert the announced reforms into changes in actual working practices.

At the IMF spring meetings in April, a package of reforms to voting rights, shifting voting power towards fast-growing economies, was endorsed by the Fund's Governors. These changes are welcome but more substantial reform along these lines will be needed if the IMF is to command widespread support amongst its membership. I intend to make that case with my international colleagues.

The current financial turmoil has highlighted just how important it is that IMF surveillance is focussed on spillover effects between countries. Its analysis should highlight the consequences of governments' policies, not just for their own economic stability, but for the stability of others. My objective is to ensure that this focus is delivered in the statement of priorities for surveillance, which will be agreed by September between staff and shareholders.

I said in my answer to question 6 that I remain concerned about global imbalances. IMF analysis has a major role to play in explaining dispassionately to national authorities the impact of their decisions on the world economy generally. I will work with other central bank governors and finance ministries, through all international groupings, to respond to the IMF's analysis and seek to resolve the global imbalances in an orderly manner.

**MERVYN ALLISTER KING**
**GOVERNOR, BANK OF ENGLAND**

**Curriculum Vitae**

Mervyn King is Governor of the Bank of England and is Chairman of the Monetary Policy Committee. He was previously Deputy Governor from 1998 to 2003, and Chief Economist and Executive Director from 1991. Mervyn King was a non-executive director of the Bank from 1990 to 1991.

Born in 1948, Mervyn King studied at King's College, Cambridge, and Harvard (as a Kennedy Scholar) and taught at Cambridge and Birmingham Universities before spells as Visiting Professor at both Harvard University and MIT. From October 1984 he was Professor of Economics at the London School of Economics where he founded the Financial Markets Group.

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