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Special Report: Carney's UK Testimony Promises To Be Insightful

- **We address the issue of rejection risk and flag key questions that BoC Governor and pending BoE Governor Mark Carney might face in his UK Parliamentary testimony.**

BoC Governor and pending BoE Governor Mark Carney's grilling by MPs in the UK House of Commons before the Treasury Select Committee on February 7th is shaping up to be interesting theatre at a minimum. We have prepared a primer on the key issues and what may be at stake.

First, it is guaranteed to be unlike the treatment afforded Carney before the Canadian Senate and House of Commons standing committees. Part of the reason for that is because there is an element of the unknown. This is unprecedented stuff in the UK as MPs have never previously been allowed to question and sign off on a candidate for BoE Governor.

Second, the Conservative-Liberal Democrat coalition government holds a one vote majority on the Committee so it requires government unanimity and/or some opposition support. This lessens the risk of unfavourable committee recommendations stemming from Carney's testimony. There are six Conservatives, four Labour, one Labour cooperative, one Liberal Democrat, and one member of the Scottish National Party.

Third, the committee does not hold veto powers but technically speaking it can set in motion a path toward ultimate rejection. This is highly unlikely not least because the coalition government holds a slim majority on the committee. Chancellor of the Exchequer George Osborne already shot down the request for veto powers but agreed to the unprecedented committee review. The fact that the committee had asked for veto powers, however, suggests that it may not be the most hospitable audience. The 13 MPs have the power to recommend against Carney's appointment and could even force a Commons vote, but doing so is perceived to be fairly rare (then again, so is the very nature of the appointment itself). Note that the coalition between the Conservatives and the Liberal Democrats holds a 79 seat majority in Parliament with 303 and 57 seats respectively versus 281 for all others after excluding the Speaker, Deputy Speakers and Sinn Fein. Thus, it may be unlikely that the coalition would put itself at risk in parliament on the issue of Carney's appointment even if it did so at the committee level, and as such Carney would likely survive such a vote in the unlikely event that it came to that. Then again, since the Committee knows this, it may be somewhat more cavalier in its recommendations.

Fourth, Carney recently noted that "The global financial system is still not as safe as it needs to be. The FSB will identify those who drag their feet or bend the rules and hold them to account." That's pretty aggressive language considering that the BoE is being granted new powers and may seek to distance itself from the Libor scandal, so he'll no doubt be grilled on his stance on the regulatory timetable including what he thinks about delaying Basel III capital adequacy and liquidity rules. His comments to date have hardly made him a fan of delaying.

Fifth, an interesting additional question could be to ask Carney about parallels between how he conducted monetary policy in Canada and circumstances in the UK, and any lessons learned through the crisis as head of Canada's central bank that may be portable to the BoE.

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Sixth — and related to #5 — is that Carney will undoubtedly be asked about his views on QE, or the BoE's asset purchase target. Canada never had the steep drop in money multipliers and velocity of money, nor the severe credit crunch that blocked monetary policy transmission channels, and Federal Reserve policy carried strong spillover effects on spreads and base yields in Canada. Therefore, we are not sure Carney has operated against a backdrop that has required a strong view on unconventional easing other than the generally successful Canadian experiment with the conditional commitment as a communications tool. Plus the Canadian Federal Department of Finance led the Insured Mortgage Purchase Program which, by definition, made it sterilized while it addressed mortgage market funding. That said, the BoC has had fairly aggressive assumptions on the effects of QE on US GDP growth which might imply that Carney favourably views its effects in a country characterized by crisis economics. Carney may therefore be indirectly asked for his UK QE views by retracing the BoC's assumptions on the impact of QE on the US and Canadian economies.

Seventh is to elaborate upon what Carney thinks about nominal GDP targeting. The UK press and the City seem to have gotten carried away with the comments in his recent speech before the Toronto CFA audience, but this will be his chance to perhaps clarify the matter. Our bias remains that NGDP targeting is a very risky idea as we wrote about in our article "Pitfalls to Nominal GDP Targeting," in the December 14, 2012 issue of our weekly *Global Views*.

Eighth, there is the question of Carney's 5-year term which is shorter than the usual 7 years, and why he has signalled he wishes to return to Canada after five years (despite the fact it is a renewable term). Part of this questioning may venture into Carney's longer-run career aspirations which Carney handled reasonably well in his recent MPR press conference so perhaps expect more of the same.

Ninth is Carney's compensation which is generating considerable heat in the UK press despite our view that talent needs to be compensated especially relative to alternative employment. We don't think the Committee has sway over this, but the headlines are not likely to be favourable in some corners. Carney's housing allowance is £250k per year for five years plus a base salary of £480k. His total package is £874k a year or about C$1.37 million at the current exchange rate and considerably higher than his predecessor.

Tenth, Governor Carney will probably be asked for his views on fiscal belt-tightening. The Governor of the Bank of England is supposed to be apolitical but Governor King has nonetheless aired his views on austerity. Carney generally declined to comment on UK politics when asked at a recent BoC press conference but could be questioned more aggressively in the UK. It should be noted that this is generally ground that Carney did not have to confront in Canada where all levels of government combined have a net debt-to-GDP ratio of about 35% at the end of 2012. That is the lowest among the G7 countries and half the OECD average of 70%. In Canada, Carney also did not face the same pressure and sensitivities with respect to commenting on Canadian government finances as his predecessors did back when Canada's government finances were much more strained.

Finally, Carney may be asked for his views on changes he may be planning for the Bank of England's operations and staff. To his enormous credit, Carney's cumulative decisions have left behind a significantly revamped Governing Council and staff. One area of sensitivity may entail querying Carney on what approach he may take to addressing the BoE's forecast track record, and Carney's own forecast track record while Governor of the Bank of Canada since 2008 may be drawn into the discussion. Carney may be questioned on adapting to the BoE culture that in some but not all respects operates with greater transparency, such as through the publication of meeting minutes and the allowance of dissenting opinions.

In short, the risk of rejection is very low, but the hearing will likely generate additional political heat for the government and further our insight into Carney's policy bias less than five months before becoming Governor of the BoE. One way or the other it promises to be higher political theatre than Carney faced as he became Governor of the BoC in his October 2007 appointment. The unusually aggressive nature of some of the questions posed to the Governor in his recent Canadian MPR press briefing may be just a warm-up.