

Bring on the new economic recovery

The UK economy is recovering from the big hit initial lockdown brought. The Chancellor did well with his generous furlough and business schemes which cushioned unemployment and limited bankruptcies. A combination of looser money policy and a large public deficit sustained activity somewhat at a time when public policy to curb the virus led to a sharp decline in output in all sectors needing social contact between customers.

Today the Bank of England thinks the sharp rise in wage and price inflation that we are witnessing will be short lived. They nonetheless aim to end their Quantitative Easing programme of new purchases of bonds by the end of this year, before the USA and the ECB. They have pencilled in the need for some modest further tightening in the following two years, which could take the form both of small increases in interest rates and an ending of purchases of government bonds when old ones are repaid. They may be optimistic in thinking we will have restored all lost output by the end of this year, and need to be careful not to dampen confidence too much too soon before recovery is well embedded.

The central task of keeping inflation down to around 2% remains a crucial target for policy. The Bank thinks inflation will be back a little below 2% in two years time, after first hitting 4%. That is possible, and I have no quibbles with them running at current settings whilst monitoring carefully wage and other cost pressures. I think the USA which has administered around twice as much monetary stimulus as the UK relative to its size and is planning to continue with a large bond buying and money creation programme has a more serious inflation threat. The USA should be doing at least as much as the Bank of England to move back to a more prudent policy given its much larger injection of cash.

Meanwhile we await the government's decision on what targets if any the Treasury needs to impose on itself. I wish to see the end to the state debt as a percentage of GDP targets continued from the Maastricht Treaty. The relevant issue is net debt interest as a percentage of GDP or of public spending. The state debt figure they use appears very high because they look at the gross figure which includes all the debt the state now owns. What matters is the debt they owe to others and the cost of servicing that debt. Despite the big increase in gross debt the position has improved since the pandemic hit, both because they have been able to buy up large quantities of the debt, and because they have forced interest rates down lowering the additional cost of new debt or of refinancing old debt.

Japan has been doing this on a colossal scale for years and has got away with it because it is a low inflation economy with a high propensity to save. The UK has a lower average age with more private sector propensity to spend and borrow so we should not assume we can continue doing this without awakening the inflationary dragon. A sensible target for debt interest and a well paced monetary tightening sensitive to growth rates is what is needed. The UK already has a debt interest target which is fine. We do not need an austerity

policy brought on by a wish to get gross debt down as a percentage of GDP. That would slow growth and make it more difficult to remove the deficit. The new policy must be growth oriented. The Bank needs to watch carefully possible inflationary transmission into wages and or excessive credit creation by commercial banks which would warrant earlier corrective action.