[Central Banks need to remember recessions bring more state borrowing as well as economic misery.]

In recent years a lot of economic advice and analysis has got too complex and out of touch . As a result the Bank of England misread inflation and presided over a major surge in prices that set in before an unexpected and unwanted European war made it worse. The Office of Budget responsibility in the last two years was way out in its underestimates of tax revenue and far too pessimistic in claiming a need for tax rises to cut the deficit. Its models did not realise revenue can be strong when there is more growth. Throughout the West the authorities decided fast money growth did not matter, and Central Banks could keep interest rates at zero whilst buying up state debt in large quantities so governments could borrow plenty on the cheap.

Central Banks are now wanting to correct their past inflationary mistakes, and are turning instead to tough money policies, pushing up interest rates, reducing their holdings of state debt and taking cash out of markets that might otherwise drive up prices. The danger is they now overshoot too far the other way, leading some countries into longer and deeper slowdowns than are needed to curb price rises. The new PM does not want the Bank to go easy on inflation, though it would also be bad news if they grew too tough. It would help them get it right if they took the growth in money and credit seriously, and watched those figures alongside evidence of any change in behaviour about how quickly the money circulated. They have tightened money substantially as they needed to do and should now wait for the impact on inflation to come through.

The new government team should want the Bank in its required reports on why inflation is running above target to provide its latest analysis of why inflation is five times target and to report on what actions it is taking to amend its models to help it forecast inflation more accurately. It would be good to hear from them about what role they now recognise the large programmes of buying bonds played in the inflation. More importantly they need to consider carefully how much impact rolling back all those bonds will have, as it will cut liquidity and slow the economy. It will make borrowing more money by the government more difficult and more expensive. Some of that is necessary. Too much of that brings on recession and paradoxically increases the debt and deficit as a result.

The OBR forecast of £99bn as I have argued before for this year’s deficit looks too low and needs to be adjusted. Without policy stimulus the economy will slow too much which will cut revenues and raise spending. With a policy stimulus which now seems likely some of the slowdown will be offset but there will be greater borrowing to cover the stimulus costs of helping people with their energy bills.

If the government decides on a large increase in state borrowing it will need the goodwill of the Bank and the markets to finance its needs. Raising the money from the long bond market is not inflationary. If rates go too high in the process that will impede growth. If Sterling falls too far that will import more inflation. There need to be sensible limits on public spending and borrowing.