

## What will the OBR predict this time?

There are plenty of independent forecasts around for those interested. No government is exempt from scrutiny, criticism or alternative views and rightly so. The problem is knowing if any of the independent forecasts are going to be right.

I understand why the government wanted the OBR to offer a new forecast when it has seen the spending plans and the growth measures of the new Ministers as well as the tax cuts. As revenues, GDP and deficits are very sensitive to whether there is growth or not one needs to form a forecast with all three crucial elements of policy.

As I have pointed out in the past the OBR has in recent years been very wrong in its forecasts. It greatly exaggerated the deficits in the last two years when I queried its view when the budget occurred. Last year it overstated the central government deficit by £131bn which lay behind Mr Sunak's tax rises. They also wrongly said inflation would stay around 2% until 2025. This year I said I thought their £99bn deficit forecast would be too low, as it clearly will.

I hope any new forecast they make will try to improve on the last two years. I will continue to look at a range of external forecasts and interpret them based on recent data and trends.

---

## The Bank's interest rate policy

I have set out before the issues surrounding the Bank of England's powers. What is not in doubt is the Bank of England has the independent duty to set interest rates. There is political agreement by all main parties that they should have and do have this power. There is usually no government or official opposition criticism of the way they use this power to show people it is independent.

In a democracy there should however be proper debate about how this aspect of economic policy is conducted, and there are plenty of external commentators who express views and provide free advice to the Bank. The last two weeks have been mainly about the level of interest rates needed in the UK to control the inflation that has been allowed to develop. The important statement came on Thursday of last week from the MPC of the Bank when they told us they were going to start selling bonds out of their portfolio. The purpose of this is to lower the price of bonds and to increase longer term interest rates. The bonds after all had been bought to do the opposite, to raise their price and cut rates. The accompanying statements and forecast were interpreted by the market as meaning there were substantial short and

longer term rate rises to come, which triggered a progressive sell off of bonds. This was on top of a global sell off triggered in the USA by the Federal Reserve Board who also signalled higher US rates and a large selling programme of US bonds which hit UK and European bonds too.

Some market participants criticised a couple of the measures in the Financial Statement on the Friday but the main focus of the gilt market remained on rates and bond prices. The markets had not been unsettled by the very expensive one off help for business and household energy bills announced a week ago Wednesday. The selling pressures in the market accelerated during the following week, reaching a crescendo on Wednesday.

The Bank then produced a statement which said it was changing policy dramatically to launch a new round of Quantitative easing with buying of longer bonds because they had come to see long interest rates were too high. This was argued on financial stability grounds. Many pension funds have geared positions in gilts, and were finding it difficult to raise money to pay the extra calls on their geared derivatives. Bond prices on Wednesday were wildly volatile on news of Bank intentions. Nothing changed on Wednesday concerning tax cuts to affect prices. It should be clear to anyone the extreme volatility on Wednesday was about the Bank's interest rate policy, not a delayed response to the Financial statement.

The Bank's statement went on to say the bond buying would end after two weeks and then sales of bonds would resume, and interest rates generally would rise. It seems that the part of the Bank that rightly worries about financial stability wants a different policy to the Monetary Policy Committee. I hope the Bank will think through what level of rates they think necessary to bring inflation down to the targets they now forecast they will hit, to give greater clarity. If it allows markets again to think it wants higher longer term rates it will create a nasty slump and balloon the very government deficit being argued about. I doubt the Bank can resume bond sales anytime soon without forcing rates too high.

Of course the Bank needs to do enough to bring inflation down. Its own forecasts say it has. It needs to tell us more about how it judges the rates needed to do this. The obvious way would be a money target like the Chinese who have low inflation. Money and credit excess last year could have warned them they were too loose and getting inflation wrong. Money and credit now points to falling inflation as it is tight in real terms.

---

## [Bonds and mortgages](#)

The Bank of England yesterday after a bruising few days for them in the bond market decided that they needed to stop selling bonds, driving prices down, and do something to try to rally them. That is good news at last. The Bank's selling came on top of the bond rout brought on by the US Central Banks

interest rate rising policy, and their own sales policy of government bonds. If the Central Banks themselves think bonds are too dear and should be brought down in price, others will agree with them.

Bonds are parts of the debt the UK government has borrowed from pension funds, insurance companies and others. They are the government promises to repay the money they borrowed. They can be sold on by the people and institutions that first lent the money to the government, so they do not have to wait for the repayment date of the loan. If the prices of the bond fall then the rate of interest you get on it goes up, and if the price rises interest rates go down. If you bought a bond where the government promised to pay just 1% interest but interest rates meanwhile had gone up to 2% then you would sell the money you lent to the government for less so the next person receiving the interest on the bond would get a 2% return on his investment. How much the bond falls by depends on when the government is going to repay the full amount anyway.

The biggest buyer of these bonds in recent years has been the Bank itself since Labour introduced the policy of the Bank buying up state debt, continued by the Coalition and the Conservatives. At its peak the Bank owned £875bn of government debt. It rightly stopped buying up more of it last year, as the policy was proving inflationary. More recently it said it would start selling some of the bonds it owns. It said it wanted to shrink its balance sheet, swollen by the large amount of bonds it owns as an asset. They started selling very recently just as global bond markets led by the USA took another nose dive on interest rate rises announced by many Central Banks and in anticipation of more rises to come. The addition of Bank of England selling implied that they wanted to see the bonds go down in value and added to the general selling pressures on UK bonds.

Yesterday the Bank acknowledged that selling now with bonds so much lower in price would not be good idea. They did not, however, say they would end the sales programme unless and until bonds had picked up substantially. That was a pity, as the value of these bonds matters to families with mortgages and businesses with longer term borrowings. All the time the Bank says it will sell as the largest potential seller it can spook the market. The Bank's wish to shrink its balance sheet has ironically been achieved in the last few weeks by the fall in the value of the bonds it holds. Crystalizing the loss makes no sense.

These interest rates matter. There are 2,5, 10, 20,30 year rates and others in between. If the 10 year or 20 year bond rate goes up so bank lending for people to buy homes will also go up, as will the cost to business of a longer term loan to invest in their company. Mortgage holders and businesses do not want their Central Bank actively intervening in the markets to drive these interest rates higher. The Bank should believe its own forecasts which show inflation tumbling next year. High energy prices and dearer mortgages are already taking too much demand out of the economy. Thank you Bank for at least a temporary pause to your driving the mortgage rates up.

---

## An answer to the green lobbyists

I am receiving several copies of a lobbying letter condemning fracking in particular and the new government's approach to energy and the road to net zero. The general complaint is we should not extract any more fossil fuel at home, run down our oil and gas industry quickly and accelerate renewable electricity.

I disagree with these emails. Let me begin by explaining they are wrong in their own terms. Substituting imported gas for home produced gas increases the amount of CO<sub>2</sub> produced globally. LNG in particular requires substantial energy use to liquefy, transport and convert back the gas compared to pipeline gas from the North Sea. Importing energy intensive products similarly entails more global CO<sub>2</sub> whilst cutting U.K. output of energy intensive products. The net zero movement must look at global impact, not just national generation. Every extra amount of home produced gas eases the global shortage a little, and cuts the overall output of CO<sub>2</sub> by saving on LNG volumes.

The pressure to go faster with expanding renewable electricity comes up against the inconvenient fact that most U.K. people heat their homes and water with gas or other fossil fuels, and most drive petrol or diesel vehicles. All the time this is true we need fossil fuels to live. If we accelerated the rate of converting our vehicle fleet to electric it would raise CO<sub>2</sub> output from the scrappage processing and from the manufacture of new electric vehicles. You need to drive a lot more miles than most car owners to make the switch favourable on CO<sub>2</sub> accounting instead of running your older vehicle for its full useful life. The CO<sub>2</sub> accounting for replacing good functioning gas boilers with electric heat pumps is also problematic. Anyway governments cannot make people rip out their gas boilers or replace their cars, especially at a time of income squeeze when most cannot afford to do so.

Meanwhile government has a duty to ensure there is sufficient energy at affordable prices to keep us warm, provide necessary supplies and buttress jobs at home. On any analysis the next few years will see the need for plenty of gas, whether from home or foreign sources and whether used to make things here or imported things from overseas. Indeed if we import more from places like China and Germany more will be made with coal based power, producing more emissions than using gas. The greens say there will be new jobs making wind turbines. There will not be enough to offset the big hit to jobs if we fail to keep enough sensibly priced hydrocarbons for the period of transition. The West is already too dependent on China and her satellites for raw materials and products required in wind farm and battery production. We also need to consider the environmental impact of mining the materials and handling the waste from battery and other electrical products.

---

## [My Interview with Mike Graham on Talk TV/Radio](#)

Yesterday I did an extensive interview with Mike Graham at Talk TV/Radio. You can watch it at: