My Speech during the Energy Prices Bill debate

Rt Hon Sir John Redwood MP (Wokingham) (Con): I welcome the Government's announcement today that this scheme should be time-limited to six months and that a different scheme should be developed against the possibility that energy prices remain very high for the months thereafter. I do not think that we can go on indefinitely at the rate of the cost of this particular scheme over the winter. If this continues, we need to target the support much more clearly on the many people and families in this country who could not afford the bills otherwise and leave those who have rather more money and are using rather more energy on luxuries to pay more of that for themselves. We have time to sort out a scheme that we can target better. I am sure that this Committee, and the dialogue that will continue, will make sure, through pressure from Back Benchers and Front Benchers, that we do not leave anybody out. It is very important that everybody has proper support one way or another so that they can afford their energy bills this winter and beyond.

I am also sure that the long-term solution is more domestic energy. We cannot carry on relying on unreliable imports, which can, at times, force our country to pay extreme prices on world markets to top up our gas or electricity because we do not have enough for ourselves. We are a fortunate country with many opportunities to produce fossil fuel and renewable energy. We have been a bit lax in recent years in not putting in enough investment, so I hope that the Secretary of State will look again at the incentives—as I am sure he will—and at the predictability of contracts and investment, so that Britain is a great place in which to invest for these purposes, and so we can exploit more of our energy and have more reliable supplies, even generating a surplus in some areas so that we can help Europe, which is very short of energy and does not have many of our natural advantages.

My concluding point is that we cannot go on for too long with a complex net of subsidies, price controls and interventions without damaging the marketplace more widely and sending the wrong signals, so I am glad that this measure will be short-term. We need a better system for the future so that there can be plenty of support for those on low incomes if energy prices remain high, but also much more investment to solve the underlying problem.

My Question to the Chancellor of the Exchequer during the Economy Statement

Rt Hon Sir John Redwood MP (Wokingham) (Con): What will the impact of these measures be on the growth rate, and will we still avoid recession?

Jeremy Hunt MP, Chancellor of the Exchequer: I will publish the economic forecasts from the OBR when I make my statement in a fortnight's time. I think it is better for me to wait until I hear that. The proper answer to my right hon. Friend's question is that what we are seeking is a long-term sustainable increase in the economic growth rate. That is a central policy of the Prime Minister, which has my wholehearted support.

My Conservative Home article on Treasury orthodoxy

So why did Kwasi Kwarteng and Liz truss campaign against Treasury orthodoxy? And why did Liz truss then give a win to that same Treasury orthodoxy by sacking her Chancellor and imposing a business tax rise just as the fans of Treasury orthodoxy had always said?

We cannot be sure. One of the strangest things was the absence of a definitive speech by either on what Treasury orthodoxy was, or why it was wrong. I think I know what they meant, but maybe my view was more conventional and restrained than theirs. The problem with challenging the establishment without explaining why or what you replace it with was you could end up losing, devoid a clear alternative. Nor was it any good sacking a High Priest of Treasury 0rthodoxy , the Permanent Secretary ,without having a ready replacement who did know what you meant and what changes you wished to make.

I have argued for some time that the Treasury and Bank are necessary institutions to impose discipline. The Treasury should do a better job at securing value for money in the many public services we do want, and at resisting demands for those extensions of state services which we cannot afford. The Bank needs to concentrate on its prime aim of keeping inflation down to 2%. Both need to sharpen their models and forecasting abilities, as in recent years they have given bad policy advice based on worse numbers.

The Treasury/OBR overstated the central government deficit by £121 bn last year. The very high number was used by Mr Sunak to justify unhelpful tax rises we did not need. Watching their model and forecasts over the years it has always had a tendency to understate revenues in an upswing and overstate them in a downswing, allied with an inability to see turning points in good time. They also do not credit revenue forecasts for some of the taxes with sufficient Laffer effect when rates are lowered, inducing more taxable activity. How can a Chancellor make good decisions when revenue can be so wrongly forecast from existing taxes? They need to amend their models to recognise the sensitivity of revenues to rates of growth and to allow that some taxes provide more revenue at lower rates.

The Treasury was at its worst over social care. It needed to make the case that the state cannot afford to take on all the costs of residential stays for elderly people who can afford to pay for them out of their savings or money released from selling their old home they no longer need or use. That has been our system for many years. Of course all healthcare is and should be free, but board and lodging is for most people with means a cost on their own resources. Instead the Treasury reached a compromise which did not guarantee to protect the full inheritance for the children whilst entailing extra costs for taxpayers which led to the hated NI rise and social care tax. These were also insufficient to pay for all the potential liabilities being unleashed.

The Bank was far too optimistic about inflation. For much of 2021 as it was busy creating £150bn more to spend on depressing interest rates on bonds the Bank assured us inflation would stay within the 2% target. Then as the year wore on it said any uptick would be transitory. As inflation prepared to hit 10% or five times target this year the Bank told us this was because of the unexpected Ukraine war hitting energy prices. So why then was inflation already at 5.5% or 2.75 times target before the war broke out? The Bank needs to take an interest in rates of change in money and credit. It does not believe that creating more money leads to more inflation, pointing out velocity of circulation or how frequently the stock of money is used can change as well. It should nonetheless be required to tell us if money and credit is growing quickly and provide a commentary if they think this is not inflationary to avoid them making the same mistake again.

Which brings us to the question what should be the controls? There are currently three. There is the inflation control. This is crucial and needs to be better enforced. The government needs to adopt it as well as the Bank. As the government spends so much in the economy it needs to take the impact on inflation into account in all its actions. There is the target to keep interest charges down as a percentage of GDP or public spending. We need this, which should be based on the cash cost of interest payments made regularly to service the bonds. It should not include the extra eventual repayments on index linked bonds which will in practice just be rolled over , nor should there be any credits for the big devaluation of repayments of nominal bonds brought on by the current high levels of inflation . Cash is what matters. There is then the Maastricht left over, debt as a percentage of GDP. This leads to bizarre decisions. As it relates to later years the figures will doubtless be well out given the poor forecasting record. Instead of this the tough inflation requirement which will constrain public spending and borrowing should be complemented by a growth target. I think 2% would be stretching compared to where we currently are, though this government has gone for 2.5%.

What the PM and Chancellor seemed to be saying was they wanted to break out of the debilitating cycle of low growth brought on by low taxes, heavy regulation and an anti enterprise culture. The world does not owe us a living and finally last year the proponents of the Orthodoxy discovered their luck had run out in simply printing more money and keeping interest rates too low. We certainly need a new orthodoxy to replace that and to get on top of the inflation it has delivered. Growth is the way out. Growth does need lower tax rates, more investment, and a stronger spirit of enterprise. It also needs more control over spending, whilst ensuring great quality core services like health and education.

[The Bank of England fights itself]

The Bank of England has two major committees. The Monetary Policy Committee is currently wanting interest rates to climb ever higher and is willing to see mortgage and other longer term rates of interest hiked as well. They regret the big inflation that has taken place, though they blame the European war rather than their own ultra low rates and bond buying in 2021. They forget that inflation was already at 5.5% before the invasion started, 175% above target. They want to start selling the large portfolio of bonds they bought up over the last decade to take big losses on the bonds and drive interest rates higher.

The Financial Policy Committee is responsible for orderly markets and avoiding financial crises. They have had to intervene in the last two weeks to temporarily reverse the MPC's policy of selling bonds and hiking rates. They have warned that rates have risen too far too fats and bonds have been too depressed. This has led to issues for some pension funds and other owners of government bonds that has worried them .

This big split has led to some announcements that seem contradictory. We are told the MPC has great resolve to make money dearer to get rid of inflation, and that the FPC needs rates lower to cut the losses on bonds to ensure stability. In 2021 the Bank was united in wanting rates as low as possible and bond prices as high as possible. In 2021 for a time the Bank was united in wanting to correct its 2021 errors by higher rates and ending bond purchases. More recently we have had the announcement of bond sales, promptly followed by the announcement of bond buying, to be followed by possible bond sales shortly afterwards. No wonder the market is disturbed.

We need stability of policy and clear signalling of intentions. Why not say the Bank has no plans to sell any bonds all the time they are this depressed? They should give early warning of any intent to sell should bonds rise to a more acceptable level. They could do what Japan does and give indications of what they think a sensible level of 10 year interest rates would be. As the Bank owns around one third of all the gilts and is such a major player they can have great influence over the interest rates and bond prices. They need to use this influence for the Goldilocks rate – the rate that brings inflation down without causing a panic or deep recession.

[Government bonds and mortgages]

I have been in demand by MPs and the media to explain how the bond markets work. As daily we have front page news of movements in the price of bonds and therefore in the longer term rate of interest, let me have another go.

If a government issues some debt to pay some of its bills, it promises to make a regular fixed payment of interest on the debt. So, let us say it sells £10,000 of debt at 1% interest to a bond buyer, as part of a much bigger issue . For ease of calculation let's say it never promises to repay – there is some debt like that. Such irredeemable debts are similar in the way they behave to long dated debt, 50-70 year debt which is repaid at the end of the stated time. The UK has been issuing some 50-70 year paper which is a debt that only repays a long time hence.

If the Central Bank then decides to put interest rates up to 2% the owner of the 1% paper is being short changed but their interest receipts stay the same. If they want to sell their bit of the debt on as they can do in the bond market, they will find that the price of it has halved. The buyer of the £10,000 bond will only pay £5000, as he wants a 2% rate and the £100 guaranteed interest payment stays the same, to give him 2% (£100 divided by £5000).

We have just lived through a period when the Bank of England has bought up £875bn worth of bonds, at ever crazier prices, taking the interest rate on them down to tiny amounts. Now they wish to drive interest rates up. They can do so by having the sole power to set the official short term rate of Bank rate which we know, currently now up to 2.25%. They can also do so by manipulating the price of bonds.

As the largest buyer of government bonds in recent years their decision at the end of last year to stop buying them pushed the market down substantially and therefore longer term rates of interest up. On the Thursday before the Kwarteng Statement the Bank announced it would go further, seeking to reduce its holdings of government bonds by a chunky £80bn. The thought of the Bank selling bonds led to price falls as the Bank must have wanted. To get the longer term interest rates up they need to get the price of bonds down.

By the following Wednesday the bond market had fallen a lot. The decline was bigger in the UK than in other countries where Central Banks were also forcing rates up, mainly because in the UK a lot of pension funds had bought into funds that let them indirectly own more bonds than they had to fully pay for. As bonds fell they had to put up more money for these geared positions, forcing yet more sales to raise money for the calls. The ECB is not threatening to sell some of its huge holdings of bonds as it is worried what that might do to their bond markets.

The Bank then decided this had gone too far and flipped from being a seller to being a buyer again of bonds to try to stabilise the prices. The Bank's own pension fund has exposures to these vehicles. On Friday they changed again, ending buying with the possible threat of sales hanging over the market. It meant the market fell sharply after the announcement of a change of policy and Chancellor.

It is true some in the markets disliked the absence of forecasts and costings with the Chancellor's measures, but as the gyrations in the week following show the main driver of bonds falling and then recovering was Bank of England action. The Bank can have a big influence on whether mortgage rates go up or go down. The commentary which sees the whole thing as a response to the mini budget is simply wrong. I have always wanted the government to set out costings and present spending and tax at the same time as is traditional.