

What should the March statement on the economy say?

The government is pleased to report that growth has been considerably stronger this year than the Treasury forecasts. Employment has grown well and unemployment is low. Tax revenues are well up, and the budget deficit was £50bn lower at the half year than forecast, and has beaten forecast a bit more since. The one piece of bad news is inflation is also well above the Bank of England's 2% target, with prices surging further on the supply disruptions caused by the Russian war.

Looking forward the danger is higher prices coupled with the planned tax rises will cut real incomes too sharply, leading to a fall in effective demand and a slowing of the economy. Far from making it easier to get the deficit down more, this will get in the way of progress in reducing the amount of new borrowing by slowing tax revenues. The government therefore proposes to reverse the impact of the tax rises. It will cancel the National Insurance hike. It will remove VAT from domestic fuel and from green products that help people cut their energy bills. It will make a modest reduction in petrol and diesel duty. As costed by the Treasury this will cost £20bn of revenue forgone, under half the amount of the financial improvement so far this financial year. In practice there will be more revenues from more jobs and more activity as these policies limit the damage to growth and output that will otherwise occur.

The government will adopt and reinforce the Bank's 2% inflation target as its own and will take actions to help expand UK domestic capacity in shortage areas where price pressures are most evident. The Bank created too much money for too long last year which helped fuel the inflation. They have now stopped this which will gradually assist in the process of getting inflation back down to more realistic levels. Inflation of 6-8% is corrosive and unhelpful to economic activity and prosperity. The UK needs to tackle more of its bottlenecks and understand the years of relying on cheap imports will no longer always be possible, as we see in the case of energy and Russian goods.