

What would a better Bank of England policy look like

The Bank and the FSA allowed far too large an expansion of credit and derivatives prior to 2007, as many pointed out at the time.

They then decided to crash the banking system by withdrawing liquidity and putting up rates, leading to the Great Recession.

Since then they have restricted banks in making new loans, and have sought to offset the negative effects of this on jobs and output by keeping interest rates near zero and creating money themselves which they inject by buying up state debt.

Savers suffer from the low rates, but benefit from the inflation of asset prices this causes. Credit is cheap from banks but rationed strictly. Alternative credit from shadow and non banking sources is quite expensive.

This is not a good model. Getting to a better one will take time and patience, but we need to sketch the direction of travel.

The first task is to wean us off QE, by setting out a programme to cancel the state debts the state now owns and to cease reinvesting the income and capital proceeds from the state owned bond portfolio. We will then see that UK state borrowing as defined by international standards is relatively modest at around 65% of GDP.

The second task is to allow the commercial banks to create a bit more credit to finance a bit higher rate of growth. This should be done by adjusting the macro prudential requirements now that the banks have much better capital and reserve ratios.

When better growth is restored then the Bank can gradually increase rates when the data justifies it.

The aim should be to end up with 2% inflation, growth at over 2% and a small real return for savers instead of a negative real return.