The Bernanke Report

Let's start with some agreement. I agree the Bank needs to improve its forecasting and the communication of its findings.

I do not agree that all Central Banks made worse forecasts over covid and Ukraine. Mr Bernanke seems to ignore China, Japan and Switzerland who kept inflation down despite the swings of oil and food prices. Their forecasts remained nearer the mark.

I do not agree that more highly paid people and more spending will provide the answer. The Bank has a lot of intelligent well qualified people. They need to correct their errors and change their thinking. The models need improving, but they have the people to do that.

It would be a good idea for a Monetary Policy Committee to look at the quantity of money being created and the velocity of circulation, and to provide comment, if only to say they have a good reasons to think creating lots of money will not be inflationary or destroying lots of money will not be recessionary so others can challenge this. Those outside the Bank that did look at the ballooning of the Bank balance sheet and money supply and warned it could prove inflationary got the forecast right even if the Bank is still sure they got the reason wrong. It would be better to have this argument around the MPC table. Why did the MPC who think inflation comes from other sources not manage to predict what happened? The MPC itself needs greater diversity of economic thought. Having someone on it who got the inflation outlook right in recent years would be a good start.

It is also a big disappointment that Mr Bernanke did not consider the impact of the waxing and waning balance sheet of the Bank. Decisions about the bond buying and selling need careful consideration as well as the interest rates. Their strong connection to public finances is also important for their impact on the economy.

The Opposition needs to understand the problems with UK government

The UK public sector is letting many people down and upsetting a lot of voters. Opposition parties in Parliament are good at criticising. They blame Ministers, as our system invites them to do. Opposition parties fail to ask why so many of the failures are in so called independent bodies with highly paid public sector chiefs paid many times a Minister. They claim just small extra sums – compared to the huge extra sums this government has tipped in – would make all the difference.

If only. If extra money would bring the NHS waiting lists down or would fix the Post Office and the railway things should be improving well by now. Ministers have tried this. Any Conservative MP will vote for a few extra billions of spending if it could deliver the end of waiting lists, good border control or a new railway line on time and to budget. We have often so voted.

There are three obvious flaws in our current governing structure, all undermining the power of Ministers to act whilst leaving them to blame. The first is independent bodies.

1. Independent bodies that get things hopelessly wrong. There is the Bank of England delivering 11% inflation whilst forecasting 2%. There is the Bank delivering recession and huge bond losses.

There is the nationalised Post Office putting honest sub postmasters into prison for its own bungled computer system, whilst losing taxpayers £1400 m and turning the PO into a bankrupt company surviving on big state subsidy.

There is HS 2, a nationalised company, trebling the cost of a new railway line and failing to deliver it on time.

There is the Board of NHS England denying the strikes of its employees are anything to with the highly paid managers who employ and roster them .

There is the Environment Agency and Ofwat failing to get the industry to put in enough reservoir capacity for a rising population or sufficient drainage capacity to keep us dry.

There is UK Government Investments charging us their big salaries to supervise the state ownership of the Post Office and most of the railway, who leave the huge losses and bad management unchallenged. They have approved large CEO salaries and bonuses to leave both these industries only able to trade with guaranteed payments of all the losses by taxpayers.

I have urged Ministers to insist on an annual budget meeting with each nationalised industry themselves to approve policy and targets, and an annual end of year meeting to discuss results and the draft annual report. A badly run industry, missing targets, should be put on a tougher regime of regular in year reviews. CEOs should not get bonuses for large losses and underperformance should lead to the sack where warnings are ignored and improvement plans fail.

Blame the Minister, but sort out the

system

It is a crucial part of our Parliamentary democracy that we do ultimately hold government Ministers to blame for the many failings of public services and public bodies. We also expect government to intervene or to change the law when the private sector and or too many individuals miscarry.

I still believe in that system. I fully understand why government gets the blame when inflation goes too high, but note that an independent Bank of England is responsible for inflation and brought high inflation on. There are so many areas now where government is blamed but in practice the decisions and budgets rest with independent bodies, or where national and international law and judges prevent Ministers carrying out what they want to do. There are even cases where Ministers change the law but are still thwarted by activist courts.

I will explore how far this removal of power has gone, how many of the independent bodies are behaving badly or incompetently, and how courts and treaties prevent Ministers implementing the public will. As many blame Ministers, Ministers need to take back powers to solve the problems the current system fails to resolve or make worse. The doctrine of independent bodies is doing plenty of damage, from the Post Office to the railways, from Ofwat to the Bank of England. The EHCR stops us controlling our borders and the WHO which had a bad covid pandemic wants more powers to control the NHS.

Bond yields and mortgage rates

In July 2022 the UK ten year interest rate was 2%. In early September it was 3% and by the time of the Kwarteng budget on 23rd September it was approaching 4%. It peaked on 9th October at 4.38%. In July 2023 it made another new peak at 4.65% and stayed high until November. It is now just over 4%.

This pattern was similar to the pattern in the USA and the Euro area. The main cause of large rate rises in all three places was the decision of their Central banks to go in for rapid and severe monetary tightening, as they belatedly woke up to the high inflation they had allowed or caused, depending on your view.

It is true that in the period September 26th to September 28th the UK had a bad sell off in gilts . This was mainly caused by the Liability Driven Investment crisis. The Bank has written of “severe dysfunction in the UK government bond market when distressed forced selling of gilts by liability driven investment funds led to a fire sale dynamic”. The IMF also wrote how “liability driven investment funds were at the centre of the severe stress that emerged in the UK gilt (bond) market”

There are those for political reasons who claim all this was brought on by so called unfunded tax cuts in the mini budget. They overlook the fact that the increases in spending were considerably higher than the tax cuts, forget that the gilt market had fallen a long way that month before the budget because the Bank wanted a big rise in interest rates, and forget the role of LDI investors the following week in driving the market down more. The Chancellor did push the deficit up more than I suggested and could have done more to control spending. Nonetheless the pattern of rate rises and falls show that the main cause of the rate increases was Bank policy, and the main cause of the three day meltdown was LDI troubles as owners of bonds they could not afford had to sell to pay their bills. It was very difficult finding buyers when they knew the Bank was about to sell £80 bn worth and LDI investors had to sell lots of bonds as well.

Further proof of this is how the Bank turned the gilt market round. By announcing purchases of bonds and suspending the planned sales the Bank brought the ten year rate back down to 3.1% by 20th November. The fact that the following year after a series of tax rises the rate went considerably higher than in September 2022 again underlines tax cuts were not the main issue.

The Bank of England losses stop a growth policy

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The scale of Bank losses

In the budget figures we were told the Bank of England’s bond buying and selling will end up losing us £102 bn. In its early phases the Bank sent the Treasury profits of £124 bn, so on these OBR estimates there are astonishing total losses coming of £226 bn. As of March 2024 the Treasury had had to pay the Bank £49 bn to cover losses to date, so another £179 bn could become due if the OBR has got a forecast right.

These losses are huge and unacceptable. A substantial portion of the loss is avoidable. The government needs to have urgent discussions with the Bank to slash these costs. Other major Central Banks including the US are not receiving any bail outs from Treasury whilst China and Switzerland did not buy too many bonds in the first place. The ECB which made similar mistakes with bonds to the UK is now containing the losses much better with a different approach.

There are two simple changes needed.

1 Stop selling bonds in the market at low prices. The bonds repay on maturity when the Bank will get more for them than current prices, so stop selling.

2. **Copy the ECB approach to payments of interest to commercial banks on their deposits at the Central Bank . The Bank of England is losing too much on the costs of remunerating the reserves placed with it by the commercial banks compared to the interest it gets on the bonds. As the rate paid to banks is a managed rate fixed by the Central Bank cut the losses.**

These changes would lead to a good improvement in the public sector deficit x Bank of England, the measurement they use to control the economy, and to lower mortgage rates.