Treasury and Bank forecasts and independence.

At last there is widespread interest in Treasury (and Bank) orthodoxy. I have been critical for sometime of the models and forecasts the Treasury and Bank provide, which do not help policy makers make good decisions. I have also been critical of the fiscal rules, which are the repackaged Maastricht rules. Under these controls and with these forecasts we have ended up with inflation five times target, and with the threat of a five quarter long recession according to the Bank. We can do better.

I have drawn attention to the Bank's confident forecasts last year that inflation this would be 2%. I queried if it was wise to continue creating so much money and keeping longer term rates so low last year when recovery was well set. I have also pointed out in answer to a Bank which says they only got it wrong because of the war in Ukraine, that inflation had already hit 5.5% in January 2022 before the war. That was some 275% of target. I disagreed with the Treasury at Budget 2021 when they forecast a huge budget deficit for 2021-2 and when Treasury advice told the Chancellor he needed to put in tax rises to plug the gap. Come the end of the forecast year they reported £131 bn less central government borrowing than estimated! I said revenue would grow faster with faster growth which we achieved. This was before any of the tax rises came in to damage it. As a result last year revenue beat forecast and model prediction by £77bn. The OBR said they did not understand why company tax had been so good, the very company tax they wanted to increase in later years by putting the rate up. It is likely the Treasury/OBR forecasts of increased revenue from higher rates next year will prove optimistic against the background of recession.

It is important to get a common understanding of OBR and Bank independence. I am not recommending less discipline or less independence. Indeed we clearly need more discipline on inflation as the current rates are unacceptable and wide of the plan and targets. Let me have another go at explaining the facts about the current control system. The Bank's MPC is independent when it comes to setting the official short term interest rate, and no-one is suggesting taking that power away. It is not independent when it comes to influencing the other key interest rates. These have been manipulated on the market by the Bank creating money and buying up large quantities of bonds to keep longer term rates down. These programmes have always required the written consent of the Chancellor, and a full Treasury guarantee against losses on the bonds. No-one can seriously claim the Bank is independent when it came to printing £895bn of new money and buying such a large portfolio of bonds. These decisions dominated money policy and interest rates for most of the last decade.

The OBR is free to publish what forecasts it wishes based on the OBR economic models at Budget time. However, the model they use is the old Treasury model they inherited. Any amendments to the model are decided jointly by the Treasury and OBR. The assumptions used to produce an official forecast run are often decided by or influenced by Treasury officials. There is much close and iterative working between Treasury and OBR officials throughout. Any government should in a free society be open to challenge over the conduct and outcomes of economic policy. It is open to any expert forecasting House to be very critical of policy or to take on official forecasts. Sensible Ministers look at outside forecasts as well as the official ones and take interest in relative success rates of forecasters.

In a later piece I will go into what may be producing poor outcomes in these official models.