DISCORDANT POLICY RHYTHMS

Strategy and economics

Richard Jeffrey - Chief Economist

The last thing you want to be heard admitting as a central bank governor is that there is just the slightest chance you got it wrong. Rule one in the central-bank handbook: governors never get it wrong, although, just occasionally, it might be conceded that, in the memorable words of Eric Morecambe, “I'm playing all the right notes – but not necessarily in the right order”.

Mark Carney, Governor of the Bank of England, did not even go this far in his comments during the press conference that accompanied the publication of the February *Inflation Report*. The report was noteworthy because it recorded a significant upwards revision to the Monetary Policy Committee’s growth forecast for 2017 to 2.1% from the 1.4% suggested last November and a mere 0.7% predicted in the aftermath of the Brexit vote in August (based on an unchanged interest rate profile). As it happens, 2.1% would be a fractionally greater increase than the 2.0% outcome for 2016 recently published by the ONS. Interestingly, as recently as August last year, the MPC was forecasting that growth in 2016 would slow to 1.6% from 2.2% in 2015.

Mr Carney cited all sorts of reasons for the upwards revision to the 2017 forecast, including stronger than expected household confidence and spending, a firmer global economy, helpful monetary policy action by the Bank, accommodative credit conditions, the fall in pound, and the fiscal easing announced by the Chancellor in his Autumn Statement. All very plausible, of course, but not entirely convincing. Most of these things are not new and some will be of marginal impact.

Conveniently, the MPC lowered its forecast for the equilibrium unemployment rate to 4.5% from 5.0% – meaning that the additional labour demand generated by faster growth should not necessitate an immediate monetary policy response. This is despite an inflation profile that shows the annual rate of increase in the CPI above the 2% target rate for the whole of the three-year forecast period. This, averred Mr Carney, “is entirely because of sterling’s fall”. Neat – but difficult to contest.

I have long been of the view that the policy-setting process in the UK is not fit for purpose. One of the prevailing watchwords has been transparency – and at face value, it does seem to be a relatively transparent process. After all, we get to know about the main aspects of the debate on the MPC and the way that people have voted very quickly after the event. However, we do not get an independent account of the committee’s machinations, and I would argue that the transparency of the voting system actually inhibits members from expressing their individual policy views (this has been confirmed to me in the past by several MPC members). It is not as if the MPC is really held to account – at least not in a way that can be considered meaningful.

I am deeply suspicious of the somewhat opaque process whereby the Bank makes its own economic projections and then uses these when setting policy, more or less without challenge. One of George Osborne’s shrewd changes was the creation of the Office for Budget Responsibility. HM Treasury no longer makes economic forecasts, nor does it judge the impact of fiscal policy decisions on the economy. This is now part of an independent process. It was Gordon Brown, of course, who established the independent Monetary Policy Committee of the Bank of England. However, the policy process thereby instituted was flawed from day one, and the degree of accountability was and remains minimal.

I believe that we should have one national body that is responsible for making projections for all aspects of the UK economy – a *National Centre for Forecasting*. This could draw on the huge pool of talent that exists both within academia and amongst professional economists and statisticians. Such a centre could be affiliated to one of our more successful academic institutions involved in the areas of economics theory and forecasting – Warwick University, perhaps. This would not necessarily preclude the MPC (or the Treasury, for that matter) from expressing differences of view, and setting policy accordingly. However, it would improve consistency between the assumptions embedded in fiscal and monetary policy decisions and it would also establish clearer paths towards accountability. Who knows – it might also save money.

This article is issued in the UK by Cazenove Capital Management which is a trading name of Schroder & Co. Limited, 12 Moorgate, London, EC2R 6DA. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Issued in the Channel Islands by Cazenove Capital Management which is a trading name of Schroders (C.I.) Limited, licensed and regulated by the Guernsey Financial Services Commission for banking and investment business; and regulated by the Jersey Financial Services Commission. Issued in Hong Kong by Cazenove Capital Management Asia Limited (“CCM Asia”) of Level 33, Two Pacific Place, 88 Queensway, Hong Kong, who provide discretionary investment management services. CCM Asia is licensed and regulated by the Securities and Futures Commission.

Nothing in this document should be deemed to constitute the provision of financial, investment or other professional advice in any way. Past performance is not a guide to future performance. The value of an investment and the income from it may go down as well as up and investors may not get back the amount originally invested.

This document may include forward-looking statements that are based upon our current opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements.

All data contained within this document is sourced from Cazenove Capital Management unless otherwise stated.