

Treasury Committee

Oral evidence: Economic forecasting, HC 565

Wednesday 21 February 2024

Ordered by the House of Commons to be published on 21 February 2024.

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Members present: Harriett Baldwin (Chair); Dame Angela Eagle; Danny Kruger.

Questions 1 - 46

Witnesses

[I](#): Professor Sir Charlie Bean, London School of Economics; Nina Skero, Chief Executive, Centre for Economics and Business Research; Jack Meaning, UK Chief Economist, Barclays.

Examination of witnesses

Witnesses: Professor Sir Charlie Bean, Nina Skero and Jack Meaning.

Q1 **Chair:** Welcome to this Treasury Committee session on the subject of economic forecasting. We are grateful to our excellent panel this afternoon for coming in and allowing us to scrutinise the challenges around economic forecasting, the Chancellor's upcoming Budget and headroom, and the associated Office for Budget Responsibility forecasts.

Before I ask our witnesses to introduce themselves, I want to say that we are particularly grateful to them because we also invited the OECD and the International Monetary Fund to come and talk about their forecasts on the UK economy. I am disappointed that scheduling did not allow the OECD to come, and I am particularly disappointed that the IMF refused to come and discuss their forecast in public. We are very disappointed, as a Committee, at their outright refusal to let us scrutinise their forecasts on the UK economy. They are a public body partly owned by the UK taxpayer, and we think they should come and give us evidence, as you have kindly agreed to do today, on economic forecasting.

So, with our three eminent and very present in the room economists here, I am going to ask you to start by introducing yourselves.

Professor Bean: These days, I am a professor of economics at the London School of Economics, but formerly I was at the Bank of England as chief economist and then deputy governor, and subsequently at the Office for Budget Responsibility on the Budget Responsibility Committee.



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Nina Skero: I am the chief executive of Cebr, the Centre for Economics and Business Research.

Jack Meaning: I am the chief UK economist at Barclays and formerly at the Bank of England.

Q2 **Chair:** Nina and Jack, I want to start by establishing what your forecasts are, and yourself Professor Bean, if you have one, for what the growth of the UK economy will be this year and what our rate of inflation will be over the course of this year. Does anyone want to share their forecast with me?

Nina Skero: We are expecting growth of 1.1% in 2024, which would be a pick-up compared to last year but still a historically relatively low rate of GDP growth.

In terms of our inflation forecast, we are expecting inflation to approach, but not return to, the target of 2%. By the end of 2024, we are expecting inflation to be around 2.2%, which is very close to the target. We are forecasting a lower rate of inflation than we would have as recently as a few months ago.

Q3 **Chair:** Professor Bean, does LSE have a specific forecasting regime?

Professor Bean: No. I am no longer formally in the forecasting game. I will say, as a general narrative on the outlook, that I would see output continuing to flatline, possibly picking up a little as we go through the year. I would not treat the growth reading for the fourth quarter of minus 0.3%, coming after minus 0.1% the previous quarter, as indicative of us heading into a deeper downturn. Some of that sharpish fall at the back end of last year can be traced to a sharp fall in retail sales in December, which has completely unwound in the January numbers and is probably associated with the difficulties of getting the seasonal adjustment right when you have Black Friday, discounting, January sales and so on. Purchasing managers' indices are consistent with modest expansion at the beginning of this year, and I do not buy the argument that there is a lot of past tightening still to work through as households with mortgages that have been fixed for a couple of years and are now resetting are suddenly waking up to the consequences. It is plausible that they would have started adjusting their behaviour already.

The fact that pay growth slightly exceeds inflation will also help to sustain consumer spending and hold it up. So I do not expect to see strong growth but continued flatlining, or flattish.

On the inflation front, it is pretty much baked-in that inflation will come back to somewhere near the target in the spring as large increases in the price level a year ago drop out of the annual comparison.

The real issue, however, is not what is going to happen in the spring, but underlying inflation, and what inflation will be further out. I do see



inflation picking up somewhat as we go through to the second part of the year. How high it goes will particularly depend on the evolution of pay.

Jack Meaning: Broadly, narratively, my view is quite similar to Nina and Sir Charlie's view of the outlook. We have quarter-on-quarter growth but pretty stagnant in the first quarter of this year. We do not think the recession carries on through more than just the two technical quarters that we had in the second half of last year, but we have still pencilled in sub-trend growth in the UK all through this year. This is an economy ticking along and stagnating, rather than accelerating to any real degree. Growth then picks up towards trend from 2025 onwards and by the end of 2025, it is above trend. The implication is that we have an output gap opening up negatively in our forecast.

There is already a negative output gap in the UK, and it widens all the way through this year, bringing disinflationary pressure. The difference in narratives between Nina, Sir Charlie and our own is that we think there will be a sharper disinflation through the course of this year. Come April, when the energy price cap changes, actual headline inflation drops lower than 2%, but then the underlying inflationary pressure essentially means that you have headline inflation below 2% all the way through the rest of 2024 and into the first half of 2025, just coming back up to target around the second half of 2025.

We essentially take the view that, because there is slack opening up in the economy, and because people are seeing headline inflation coming down, underlying wage pressure will moderate more quickly than the Bank of England or, arguably, other panellists believe. That leads us to a slightly softer view on prices going forwards.

Q4 **Chair:** Given that we are a few weeks ahead of the Chancellor's Budget, could you share with us what you think is the characteristic of the fiscal rules against which the Chancellor measures UK performance? Do the Chancellor's fiscal rules themselves make sense?

Professor Bean: The general principle that the debt-to-GDP ratio should be falling in good times makes sense. Basically, the big picture of public debt is that it should go up in bad times: wars, pandemics, things like that, perhaps big energy shocks if you are giving temporary support to households. In return for that, you obviously have to make room in the good times to create the fiscal space for dealing with the next bad shot that comes along. That is just sensibly sharing the burden.

Q5 **Chair:** That is not what the fiscal rule actually says.

Professor Bean: Well, no, the fiscal rule is to have the debt-to-GDP ratio falling five years out, so I am starting from what is basically a sensible objective. Of course, the way that is actually encoded is that the debt-to-GDP ratio five years out is supposed to be falling, and the Chancellor typically keeps a small amount of headroom for that.



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The way it tends to be pursued is not terribly sensible in that it is very sensitive to where the OBR's forecast turns out to be. If that moves £5 billion one way, then, because the Chancellor is aiming to keep £15 billion, or £20 billion or whatever, of headroom relative to hitting that objective, it immediately translates across into £5 billion room for some fiscal action.

Given that the forecasts are very sensitive—borrowing is the difference in two large numbers of tax and spend—relatively modest changes in assumptions about, say, where interest rates will go or where prices and GDP will go, and the rate of productivity growth, can lead to that number moving around quite a lot.

Personally, I think it would be desirable to operate the regime in a way that makes it less sensitive to the precise judgments that are embodied in the OBR's forecast. This is not a criticism of the OBR—the inevitable result of forecasting is that there is a lot of uncertainty—but it is a question about how you use that information. Instead of trying to hit things with pinpoint accuracy, having a fuzzier link would make sense.

Q6 Chair: Nina, do you have a different point of view than that?

Nina Skero: I do not disagree with the principles of the fiscal rules, but the way in which they are applied at the moment makes them close to meaningless. On whether the five-year horizon is the right length of time, shortening that horizon would not necessarily be the solution. As long as you have fiscal rules that rely on a future date that can be rolling, whether it is five years or four years, does not make a big difference. There have been many iterations of fiscal rules in a short time span, and I understand the pros and cons of both.

In terms of having a set of rules that the Chancellor sticks to, it is a little easier to monitor something that takes an annual view: where every year, or every normal year, you are meant to be getting closer to a target.

Q7 Chair: Do the fiscal rules make sense to you, Jack?

Jack Meaning: I echo what the previous two panellists have said, but there are some things I would add. Obviously, no rule is perfect, and there are two specific issues with the current fiscal rules as they stand.

First, there is the nature of a rule which is attached to a forecast. The OBR has, by most measures, a very good forecasting performance, but five years into the future their forecast for GDP growth could be, on average, plus or minus 1% wrong. When we are talking about a headroom of 0.5% GDP, systematic forecast errors of that kind can make a lot of difference. That is not, as Charlie said, a criticism of the OBR. It is inherent in the nature of forecasting so, in that sense, having any rule that is attached to a forecast out into the future is problematic. You cannot remove that uncertainty in any meaningful way.



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Secondly is the specific fiscal rule at the moment, which is about what happens in the fifth year of the forecast as opposed to anything more short term. The problem with that is it can be gamed, in the sense that it does not matter how high the level of debt you have is, as long as you manage to engineer something in the forecast that means it comes down in the future. You can put in things that may never materialise, may even stretch credulity, and suddenly meet your fiscal rule. Or you could have something which is eminently plausible, but because it is not in keeping with the fiscal rule as set, you miss out on a policy that would have been useful.

Those two differences are quite important.

Q8 Chair: Of course, it is ex-Bank of England impact, and the Bank of England impact is also quite significant these days.

Given that we have heard it is very difficult to predict with any certainty, let alone five years' time ahead, I am nevertheless now going to ask you all to predict, based on your estimate, how much headroom you think the Chancellor has going into the upcoming Budget. Who wants to start with that? Jack, you are nodding enthusiastically.

Jack Meaning: An extra trick from people like me in the private sector is that we are not trying to forecast what we think the future will look like, but what the OBR will think the future looks like. We have crunched those numbers to forecast a forecast.

Chair: Mind-reading.

Jack Meaning: With that stated, we broadly think that there is about £19 billion of headroom, maybe a little less, given the fact that the yield curve has moved a little in the last day or so, but roughly £19 billion would be commensurate with what we see as the OBR's changes to their forecasts, with a yield curve that is slightly lower which reduces interest costs for the Government. With inflation coming down, you see a change in real GDP, which means that nominal GDP comes down a little, but so do costs on index-linked bonds. That means we think it expands from the roughly £13 billion we had last time to more like £19 billion at this forecast.

Q9 Chair: Obviously that is a mind-blowingly large sum of money for any individual, but can you give us a sense of what it is as a percentage of the whole UK economy? It is not a very large amount, is it?

Jack Meaning: No, it is less than 1%.

Q10 Chair: Professor Bean, do you have any difference of opinion on that?

Professor Bean: No, it is a perfectly plausible number. The one thing I would say about these calculations is that, having seen things from the inside, there can be a lot of moving parts that go into them.



There are some obvious things on the outside that you know will affect the potential fiscal headroom. The most obvious is changes in the yield curve. Roughly speaking, if the yield curve, the whole way along—short rates, long rates and so forth—falls by a percentage point, that creates another £14 billion. If the price level is one percentage point lower, that loses you some tax revenues, but in offset, benefits will be lower because of the lower indexation. So, from the outside, you can take a punt at what those things might add up to, but there are other assessments that the OBR has to make. Insofar as tax revenues have turned out different from expectations, they will need to take a view as to whether this is just temporary noise or something permanent and persistent which will lead the level of tax revenues to be higher in the medium term. From the outside, it is really very difficult to form a view on those things.

Obviously, there have been suggestions in the press that there may not be very much fiscal headroom left, and certainly if you go back a month or so ago, before the recent move up in interest rates, it would be reasonable to think that there might be £10 billion or £15 billion, something like that. It looks as if it will be rather less but exactly how much is difficult to know. And there is of course a question about how much the Chancellor wants to keep in headroom as insurance, if you like, against further shocks.

Q11 Chair: From your perspective, having worked within the OBR—it is an iterative process as you say—what is the point at which it all gets locked in? Is it about a week before the Budget?

Professor Bean: It is further ahead than that in terms of the forecast. Basically, there are three iterations of the macro forecast and the associated fiscal numbers, which then get locked down. I have forgotten exactly how far ahead, but maybe three or four weeks ahead of the Budget day so that the Chancellor has a stable base on which to work. The thing is, it is impossible for him to make decisions if the base is continually moving from one round to the next, so everything gets locked down after round three, as it is called, which helps the Chancellor's own planning.

Q12 Chair: Nina, do you have an estimate of how much headroom the Chancellor has?

Nina Skero: I imagine we have taken rather the same inputs and come up with a very similar figure of around £20 billion. That is the figure, or something close to it, that I would expect the Chancellor to mention as the estimate of the fiscal headroom, keeping the more recent developments that add colour to the economic context. We have data showing a mild recession, but still a recession at the end of 2023. We actually think we are already out of that recession, but it is certainly not a position of economic strength.

Data came out this morning which the Chancellor would probably be happy with in terms of messaging, in terms of how much headroom there



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is, so it will be a balancing act. There is a lot you could point to that would show the economy is flatlining and that it would be prudent to try to rebalance the position from the recent expenditure. On the other hand, you could also make the case that receipts have been exceptionally high, so there is a little room. It will be a balancing act, but I agree fundamentally with what has already been said.

Q13 Dame Angela Eagle: Thank you all very much. There has been increasing controversy about forecasting, and obviously Ben Bernanke is to review the Bank of England's forecast models. You are all forecasters, or have been—

Professor Bean: I am a retired forecaster.

Dame Angela Eagle: Yes, but a very experienced one.

To what extent do you think this is just grumbling about what the forecasts are saying, and to what extent do you think forecasting can be defended as a process? Is it simply something that reflects the—quite heroic in some cases—assumptions that underlie the decision-making in the forecast itself? Is it objective? Can it be something we can take account of, or is it just a generated process, the outcome of which is determined by the assumptions implied in it?

Professor Bean: That is quite a lot to unpack. First, it is important to realise that you cannot expect economic forecasts to be precise.

Dame Angela Eagle: They are not predictions of the future.

Professor Bean: They are not predictions, and of course, there are plenty of examples where something might be well-behaved but you would never be able to predict it perfectly. Take, for example, throwing a couple of dice: your best prediction is a seven, but you would not expect a seven to necessarily come up at that particular throw; seven will dominate only if you throw the dice lots of times. So, there is always going to be a distribution around that. Some forecasting uncertainty is of that variety.

On top of that, and this is where forecasts very often go wrong, is that the nature of the things that happen are not just drawn from a statistical distribution. There is no basis for trying to calibrate the likelihood of events such as the covid pandemic, the war in Ukraine, the financial crisis and the possible break-up of the eurozone. Nevertheless, forecasts can be useful. I think of forecasts as quantitative stories, quantitative narratives. The value of putting the quantitative in there is that it stops you assuming things which are actually just implausible in terms of magnitude. You have to have things that fit together sensibly. The way models do that is essentially using past experience and past evidence to calibrate the size of relationships between different variables in the economy. That is a useful exercise, not only for thinking about where the most likely broad trajectory of the economy is but also about the risks



and the nature of the risks on either side, which is something we might come on to later.

- Q14 **Dame Angela Eagle:** That is a good summary. We are in a period at the moment where we have had a lot of exogenous shocks that models do not predict and forecasts cannot predict, and we are also in circumstances where we have to think about retooling our entire economy in order to deal with the threat of climate change, an existential threat which requires re-engineering of the sort that we have not seen in a very, very long time, if ever. In that context, to what extent do forecasts that have been quite predictive and good guides in the past have relevance in the immediate and medium term future?

Professor Bean: You have to be very careful not to mindlessly apply a model which might have fitted a particular period in the past to a conjuncture where it may no longer be relevant. What is important with all economic models and forecasting and the like is to be aware of their limitations and when you need to use a different toolkit, a different model.

When you get into thinking about situations which are not really like those you have encountered in the past that your original model might have been calibrated on, you need to start thinking, "How might the world be different in this new setting?" That requires the analysts to go beyond simply cranking their existing set of equations.

An obvious example is when I was at the OBR and we had our first stab at trying to assess the impact of the pandemic and lockdowns on the economy and public finances. The existing Treasury model that the OBR uses could not effectively answer that question, so we were using other ways of approaching the problem. In relation to lockdowns, we considered which sectors of the economy were likely to be shut, to what extent people could still trade even though they might not formally be able to open their shop, the effect of social distancing, and so on. You need to look for other information to help you get a broad handle on the magnitudes that might be involved. You are in a world where you are not quite completely in the dark, but there is a lot of conjecture going on, so you need to be very conscious of the potential limitations of the analysis, and appropriately humble.

- Q15 **Dame Angela Eagle:** Do you think that the underlying economic assumptions which have been part of the toolkit of economists for many years are fit for purpose in this new era? For example, the general view that lots of economists have about what the relative balance of tax and fiscal policy and investment should be? In an era like this, where there needs to be a complete retooling, do we need some updates in economic theory to deal with the position we are in, or do the old models of small state and big state still apply?

Professor Bean: I would distinguish between the theory and the models.



Q16 Dame Angela Eagle: Do the models not imply the theoretical and sometimes even theological economic beliefs in the way in which they work?

Professor Bean: No. Theory is a toolkit to use, and a model will be a particular embodiment of that, which may be useful in some circumstances and not in others. The hallmark of a good analyst, a good forecaster, if you like, is somebody who can identify the appropriate model for the particular issue that they want to look at.

For the particular issue you have raised—climate change and the challenges associated with it—I would suggest that the general tools of economics and incentives, and how households and businesses behave and respond to those incentives, are going to be extremely valuable in understanding the appropriate policy response. You will not find that by looking inside the Bank of England’s forecasting model or the OBR’s forecasting model, but the tools of analysis and the empirical work that people have done which illuminate the strength of particular phenomena may well be important. It may also be important to bring in insights from other disciplines. For climate change, you obviously need to bring in insights from climate science, and for understanding the effect of the pandemic, we needed to bring in insights from epidemiology. So, you have to be appropriately catholic in the information that you bring to bear.

I would emphasise that the way to think about this is as a toolkit with a set of tools you can apply, and the key is to pick the right tools to use for the particular problem you want to look at.

Q17 Dame Angela Eagle: We have to be both humble and catholic, is what I get from that.

I wanted to ask about growth and productivity, both of which have disappointed enormously. People will argue about the reasons for that, but I am more interested in what we can do to improve the situation. Productivity continues to decline; even though we have full expensing and a range of 120 growth measures, growth still bumps along the bottom. If you were Chancellor for a day, what do you think you would want to be doing about those two very important issues?

Professor Bean: If your objective is to increase growth, you want to increase physical capital formation, both public and private, and increase human capital formation: education, skills acquisition, and things like that. Increased labour force participation is of course something the Government have been trying to do recently, and some of the measures in the last couple of fiscal events have been focused on things like improving childcare provision. When it comes to the black box part of it, you can increase the means of production, capital, labour, and so forth, but the magic factor is how those are combined into output, sometimes referred to as the methods of production.



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The big driver of growth in living standards over many years is actually that magic factor, that black box, that economists refer to as total factor productivity. Unfortunately, the forces that drive it are not well understood. The slowdown in productivity you referred to is essentially primarily driven by a slowdown in total factor productivity growth. It is not a UK-specific phenomenon; it is observed in many other countries as well. It is not associated just with the aftermath of the financial crisis because it started in the US in about 2003. In some ways it is puzzling because when you think about all the inventions that are taking place—AI and advances in computing, nanotechnology, and so on—they do not really show up in the productivity numbers, or at least have not shown up yet. Because economies do not really have a good handle on what drives the magic factor, total factor productivity, that is an element which is much harder for us to act on.

From a UK policy perspective, it is notable that not only has our productivity growth slowed since around the time of the financial crisis, our relative productivity levels are also disappointing, and they have been for a long time. That can be traced very specifically to low investment rates in both public and private capital and educational attainment and skills, which, at least for the bulk of the workforce, are not as good as they could be.

So, in terms of where you focus your policy, it is sensible to be focusing on the parts that we know we might have some ability to influence and where we know we lag compared to other countries.

Q18 Dame Angela Eagle: I am going to make an observation about that because I do not disagree with you at all, but capital formation, public and private, and human capital formation, essentially education and skills, however acquired, rely a lot on public investment. Obviously the private sector invests when it feels it is going to make a profit and it feels upbeat about the prospects of that being a successful investment. But the paradox is surely that such an approach implies public expenditure of the sort that, if we look at the forward-looking plans that have already been published, is going to be quite hard to achieve because of the 0.9% real-terms cut in public spending, which is factored into 2026-27 in the spending review.

Professor Bean: That is indeed the case. The fiscal outlook is extremely challenging, essentially because of the environment that we are in. We have talked about the fact that the cake is not growing very fast. If the cake was growing bigger, and we had faster productivity growth, that would help, but if you are thinking about the demands on the state—

Q19 Dame Angela Eagle: We have not even talked about the ageing population, which takes the rest of the income.

Professor Bean: Precisely. I was going to come to that. One of the key challenges is the ageing population. Increased longevity obviously increases expenditure on pensions—particularly as we have also taken



the decision to increase the generosity of those pensions—and it increases expenditure on healthcare.

There is a lot of discussion at the moment about the share of spending and the share of taxes being at historically relatively high levels, but one of the interesting things is that over the last 50 years, the share of government spending in GDP has not changed very much. It goes up and down a little with the business cycle, maybe depending on which party is in power, but the big picture is that government spending has always been about 40% of GDP. Beneath the surface however, there is a lot going on.

If you go back 50 years, about a quarter of that spending was on health and welfare, including pensions. That has risen to about a half, essentially because of demographic forces—ageing—and the nature of technical change in the health sector. Basically, if new treatments are invented that are expensive, but extend life a little, there is a big demand to make them available. At this point you might say, if the share of those elements has gone from a quarter to nearly a half of government spending, how has that been possible? The answer is that three things have made room for it.

First, there have been declines in public investment. Secondly, there have been declines in defence spending, initially around the end of the empire and then the end of the cold war. Thirdly, there has been a falling contribution from debt interest.

All three things, which have been helping us, have turned around and are going the other way. On top of that, we have the challenge of dealing with climate change. There is an open question about how much the state may need to play in that role, but potentially there may be more expenditure there.

So, I see it as an extremely challenging fiscal context, and in that setting, if you want to talk about reducing the tax burden—which is a perfectly reasonable objective that some people may want to pursue—you have to explain how you are going to be able to deliver that. It will require some significant re-engineering of what the state does at the same time.

Q20 Dame Angela Eagle: It may be that state spending in those circumstances is going to be front-end loaded to trigger the change and to give an indication of direction, which would then give the private sector more confidence to move into the areas that it needs to move into. So it may be that there is a front-end loaded cost which could come down later once the change has taken place.

Professor Bean: That is, essentially, an investment: you do something now, and it pays off in the future. The key thing is that it has to be an action where you are not just trying to kid yourself that it is going to deliver in the future, you have to have a reasonable confidence that it will help.



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- Q21 **Danny Kruger:** Thank you so much. It is such an interesting conversation; let us just carry it on and unpick some of what has been said. I like the thought of being humble and catholic in our deliberations; it is good; and it is good to have theology mentioned as well. During your exchange with Angela, a question occurred to me on beliefs. This is an economic forecast, so I am not asking you to speculate totally metaphysically, but I would like to hear from each of you whether you think the net zero policies the British Government are proposing will help to stimulate economic growth and address some of the challenges we have been discussing around productivity within the timeframe we are looking at, which is the next decade or two? That is not to say we should not do them if they do not, but I am interested to know whether you think there is a net cost to net zero or whether, actually, it would be good for our economy.

Jack Meaning: I am happy to pick that up as a first pass. This is a transition that feels like it needs to happen. It is a transition that is well in train, and one in which there is a definite advantage in the sense that these are industries and sectors that will, in the immediate term, be more productive. They are places where there is a lot of growth and a lot of development; they are industries that use highly-skilled workers and lots of knowledge for a knowledge economy, so those things straight off the bat will be very good for UK productivity. That will take time to feed through as it builds up, but the immediate analysis would suggest this is a positive thing in terms of growth, even before you get to the question of what the alternative is if you do not do these things. How does your economy look if you do not do these things? As you fall behind international competitors, as you realise other places have instituted cleaner fuels, more efficient housing? If you find yourself at an international disadvantage, then how does that play out in a relative sense?

- Q22 **Danny Kruger:** Do you only see an upside to net zero?

Jack Meaning: No, that is the benefit that accrues. Partly going back to the conversation that Dame Angela and Sir Charlie were having though: in order to get there, there is certainly a cost. The transition itself has a cost. The fact you know you have to get to this end-point and the fact that when you get to that end-point, that has ultimately been a beneficial thing for productivity, for growth, probably for living standards as well, is one thing, but the fact it takes an investment and a cost, which has to come at the expense of other things, is a near-term cost for a longer-term gain. That said, how you manage that and how extreme that is—I am not a climate economist, so it is slightly out of my area of expertise to give advice on how that is managed—is certainly the trade-off in the near term: that there is a redistribution of resources from things people are currently employed in and are currently invested in, into something which will ultimately give a long-term gain but has a cost of transition.

Purely from, say, a labour force point of view, do we currently have sufficient people who are skilled to a sufficient level in the right industries



to be able to meet that need? Arguably not. Is there a cost to making someone who is currently a builder on a building site learn how to retrofit buildings and improve efficiency? There is certainly a cost to that, and there is a personal cost to them. There is a cost to the state of funding it if the state sees so fit. Trading that near-term cost against what is unambiguously, in my mind, a longer-term gain is the policy decision.

Nina Skero: I would agree with a lot of that. You specifically mentioned a 10-year time horizon which, if we are talking about forecasting, can seem like a long period but, in terms of the energy transition, it is not a very long time. Certainly, within that period of time, net, it would probably be a detriment to growth and, as you mentioned in the wording of the question, that is not a reason not to do it. But all things considered, on that short of a time horizon, the policies being discussed at the moment and that are planned over the next decade are not designed to boost economic growth, they come from a wider perspective.

Q23 **Danny Kruger:** Do you think they may have a dampening effect on growth over that timeframe?

Nina Skero: I do not think a devastating impact on growth and there are a lot of other things at play, but—

Danny Kruger: I said a dampening effect.

Nina Skero: A dampening, sorry. Yes, I would agree they would have a dampening effect.

Danny Kruger: Thank you.

Professor Bean: One thing that is important to remember is that GDP is not a measure of welfare in this. To the extent you are putting resources into dealing with climate change, you are obviously having an adverse impact on current consumption possibilities, current welfare and things like that. Nevertheless, you may be raising GDP. I am not so sure it would necessarily dampen it, but you can be having an effect on GDP yet also having an adverse effect on current living standards.

Danny Kruger: Indeed. You are placing that cost on households.

Professor Bean: Yes, but the return from that is that further down the road you have a greener economy. Assuming everybody else in the world does it—which is pretty central in this—then you probably have a much better position welfare-wise than if you had not done it. We know there can be some pretty serious costs if global warming continues unchecked at the current pace.

Q24 **Danny Kruger:** So, the long-term economic benefit of net zero will only be felt if we succeed in encouraging the rest of the world to follow suit? Otherwise, it is a cost that we have undertaken for no benefit to ourselves.



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Professor Bean: That would be true because, basically, the UK is not big enough to affect the global stock of emissions. The argument for us doing it is part of the process of encouraging other countries to also do it. Basically, this is a collective action problem.

Q25 **Danny Kruger:** Jack's argument is that there is a direct economic benefit to the transition because, effectively, it is an industrial strategy and that is the value of it. It is about improving the productivity, the enterprise of the UK, which, in time, will be beneficial on its own terms.

Jack Meaning: Where I would agree with Sir Charlie is that if we do not get the international community behind this agenda, then our ability to be able to stop global warming going beyond the bounds of what is useful is incredibly limited. Therefore, in a very big picture sense, it is futile because you end up in a world where global warming still happens.

Danny Kruger: And we are poorer.

Jack Meaning: Even on a more parochial, narrow view than that, to have a more efficient housing stock that is more energy efficient, to have more highly-skilled workers, all those things, means if there is a future energy price shock and the cost of electricity goes up, UK households will be better than international partners in being able to meet that.

Q26 **Danny Kruger:** It would be good to be able to generate more of our own energy, that is for sure, and I agree about the skills and insulation and so on. Okay, that is very helpful. Can I come on to questions around the labour market and the effect of the forecasting there?

Just for context, yesterday we had the Governor of the Bank of England in and he was pointing out that we are at full employment; it is a circumstance of our economy. It is also true that we have 9 million people of working age who are not working, so we might have full employment by one measure, but we also have a very large number of people who are not working. In the OBR's outlook in November, it suggested that the two major labour market interventions, as it were, in the autumn statement were the cuts to national insurance and the welfare reforms.

The autumn statement introduced cuts to NICs which will, according to the OBR, raise employment by 28,000 new people coming into the workforce from inactivity or unemployment. It will also improve current employees taking on more work, equivalent to 94,000 full-time workers. So, whatever that is, 125,000 full-time equivalent new workers in the context of the 9 million inactivity rate does not seem enormous. Likewise, according to the OBR, the welfare reforms will raise employment by 50,000. These are very welcome changes, but in themselves they do not seem enormous. Do you think I am giving insufficient credit to these changes and, actually, that is quite significant? If I am right that this is not a great deal, what do you think could be done to increase labour market participation? That is for anybody who wants to respond.



Professor Bean: There are two things I will point to that one would like to do something about; one is long-term sickness. I have forgotten the exact number, but at the moment there are about 2.8 million long-term sick out of the labour force. Reintegrating some of those into the labour force—obviously you cannot do it for all of them—would potentially be very valuable.

Another potentially useful margin is older workers. One of the consequences of the pandemic was about half a million people left the labour force and the previous trend would have actually had it rising by about half a million. Quite a lot of those workers were older workers. Some of that may be to do with the effect of the pandemic making people realise their mortality or whatever but, going back to the earlier discussion about ageing and so forth, one of the ways of responding to that is to try to facilitate longer participation in the labour force. I am an old geezer, I am 70 now and I am still participating in the labour force, so we need more people doing that.

Q27 Danny Kruger: Indeed. Of course, that is exactly what the Government are doing and these measures I mentioned are intended to have that effect.

Jack and Nina, do you think we—and specifically the OBR—correctly estimate impacts of these fiscal decisions on the labour market? Do you think we are good at predicting labour market effects? Of course, famously through the pandemic, we expected there to be unemployment at the end of it but it in fact had the opposite effect. As Charlie said, people did not want to go back to work.

Jack Meaning: In general, I would say the OBR and its forecasting performance does not appear to be broadly any worse than economic forecasters in the labour market or anywhere else within the economy. At the moment, there are a couple of things posing particular problems: labour market data means we are struggling to know where we are, let alone where we are going in the future. There is an incredible amount of uncertainty and volatility about the data we are using: it is changing month to month, print to print. For all forecasters, the OBR included, there is an additional uncertainty in the labour market at the moment.

There is a particular question around the estimates you have just put there, and I would say our own forecast does not really see very much of an impact on employment from the policies announced at the last autumn statement. This is largely because our view is that—again, this is where judgment comes into forecasting—the sensitivity of people who are currently registered as long-term sick to changes in income levels, especially the income levels we have been talking about in terms of the NICs change, is pretty small.

We have seen the people who drifted, as Charlie said, into long-term sick. We have seen some of that correct; we have seen people come back in. However, the question you really need to ask yourself when you are



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assessing that policy is how sensitive those who are now inactive are to whether they get an extra penny off NICs. Our assessment and judgment in our own forecast was, not particularly. The people who had been sensitive had already moved back in.

More generally, in terms of policies for the labour market and things that would really boost our view of employment in the UK over the next year or two, it is about growing the economy. You can try to bring people in at the margin from inactivity, and that is a very important and admirable thing in terms of inclusivity and making sure we are using our resources as well as we can but, actually, if you have an economy that is growing rather than stagnating, people are going to feel more confident as firms are taking people on to work. That is going to increase people's incomes and that is then going to have a virtuous cycle of boosting future employment. These types of policies, even on the OBR's estimates, are relatively small.

Q28 Danny Kruger: So wage growth is what is needed?

Jack Meaning: Economic growth is what is needed, and economic growth, especially if it is driven by productivity, can lead to wage growth.

Q29 Danny Kruger: Nina, I am going to ask you another question, unless you are very keen to jump in on that one?

Nina Skero: I can add a few brief points. In terms of the impact from the policies of the autumn statement, we did not specifically calculate the impact of those. That actually speaks for itself because clearly we did not think it would have a material impact. In terms of the labour market picture more broadly, the furlough example you mentioned is an interesting one and obviously it has had a very material impact on the labour market, even up to now. The policy was a success in the sense that it protected livelihoods and is one of the major reasons there was not a bigger spike, or not even really a spike, in unemployment.

I am not advocating for this, but it is worth comparing that approach during the pandemic to the US approach, for example, which let more of that shock be felt through and did not protect jobs as much. You could argue in some industries that it has, to an extent, actually led to productivity gains you would not have seen here because people were very much shielded to stay in their current roles. That is certainly a success but, if you are taking a very holistic view in terms of the impact it has had on productivity, on the labour market, it is worth considering that as well.

I just want to echo something that was mentioned on childcare earlier in our discussion. I feel there is a lot of public discourse at the moment which suggests that childcare has been sorted because of the announcements that were made, not at the last fiscal event but I believe two fiscal events ago. Maybe it is a drop in the bucket, but the UK,



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compared to comparable economies, still has far higher childcare costs, so the sense that box has been ticked is a false sense.

Q30 Danny Kruger: A lot of money has been put in, but the market remains very inflexible and, therefore, the costs are very high for childcare?

Nina Skero: Yes. Of course, not all that is on the Government. There are government incentives, for example, for employers to provide employer-organised childcare, but they are not very heavily utilised. This sense that we have now addressed the issue because a lot of money has gone in that direction is, however, a false sense.

Danny Kruger: Chair, do we have time for another question or two?

Chair: Of course.

Q31 Danny Kruger: Nina, I will stick with you. Life has got very real, has it not, in the last few years? We are suddenly conscious of very significant, as it were, physical realities in our world. We all started thinking about the Suez Canal and shipping, where all the container ships were, all these kinds of questions, in a way we had not thought about for some years. How good do you think the forecasting industry—and I guess the OBR is the main one, but the Bank and private forecasters as well—is at modelling supply shocks in general? Do you think we, or you, have learned anything from covid, Ukraine, Brexit, in terms of modelling the effects of supply shocks on the UK economy?

Nina Skero: We have learned a lot. I know there has been a lot of criticism around various forecasting exercises but, in my view, a wrong forecast is one that ultimately leads to a bad policy decision, and then that bad policy decision has negative consequences. If we talk about a bad forecast as a forecast that did not match outturn data, I would be a lot more forgiving. Not just because I run a forecasting agency myself but, in terms of economic data, the past can sometimes be as uncertain as the future. You can never be sure you have a forecast correct because there can always be revisions. The review of the Bank of England—its forecasting in recent years—that is going on now is justified because that is an example of something where forecasts led to negative consequences and there should be a review.

In terms of modelling shocks, to some extent private sector forecasters have an advantage over the public sector because we have a lot more leeway. If something like a pandemic or the energy supply shock happens, we have a lot more ability to respond quickly by, for example, doing something off-model or by applying judgment to a model. That is one of the lessons we have learned: that some things need to be run on a smaller model because if you are running a model that maybe contains a couple of thousand equations, your ability to incorporate a change in circumstance is going to be massively reduced. So, that has been one takeaway, and is something the public sector would, I expect, find harder to integrate.



Q32 **Danny Kruger:** Are you happy with what you know of Ben Bernanke's review, the terms of reference for that, and what he is doing to try to help the Bank?

Nina Skero: I think I have a good understanding of it.

Q33 **Danny Kruger:** Do you think he has been correctly commissioned and is doing the right sort of work, as far as you know? We do not know what he is going to say yet, but in terms of what he was asked to do, do you think the question was the right one?

Nina Skero: It is a broadbrush review and I would have specific points of criticism. Very importantly, it does not only look at forecasting practices, but practices around them as well. I would expect that one of the takeaways that has already been mentioned is this difference in the style of communication coming from the Bank of England versus, primarily, the Fed. I would say it is a very encouraging sign that it seems to be taking a very broadbrush review rather than just focusing specifically on modelling work.

Q34 **Danny Kruger:** My last question is one which anyone can answer because it is a very general and somewhat theological one. The nation-state is re-emerging as a player in the world. Since the end of the cold war, we assumed we were going to be a fully globalised economy. We are seeing tariffs go up; we are seeing domestic subsidies return. The UK is still trying to hold on to the idea of being a global trading nation above all. Do you model, and what would be your very high-level predictions of, as it were, a retreat to a more protectionist UK if we were to restrict inward migration, support domestic manufacturers, and restrict imports particularly around high-carbon emitting countries that we currently do not? What would be your sense of the long-term or, indeed, short-term, economic effects of us following that approach?

Jack Meaning: I should say, in my role at Barclays, we have not done specific empirical work on this, but I was fortunate enough to be at the National Institute of Economic and Social Research in 2015-16, leading on a lot of their work on trade relationships building up to the EU referendum and saw that evidence. The type of thing you are describing in terms of dislocation of trade agreements, restrictions of free movement of labour, all those types of things, are broadly the same economic principles we were dealing with then. I have to say that, across a whole range of estimates, across a whole range of scenarios, more frictions in your trading relationships between your big trading partners is negative.

Q35 **Danny Kruger:** Were you worried then about security of supply of energy, food, and technology in the way we are now?

Jack Meaning: No. This has been the learning on top of that in the world as it has changed. Partly, when we are working with pure economic models and the pure economics of things, we can follow those models and we can say the economic case is incontrovertible; this is a completely



negative thing. One of the things economists across the board have probably learned in the last five to 10 years has been that, actually, there are broader considerations than the macroeconomic—is GDP up or is GDP down—type things we tend to look at. Some of those more geopolitical concerns, or some of those more tail events that could happen, those are things we have learned to give a bit of weight to. However, that is still weighed against what is a relatively broad and deep literature and the fact that, actually, if you put up trade barriers—

Q36 **Danny Kruger:** In a perfect world, lack of friction is good, yes? In the real world, it might help. What do you think, Charlie?

Professor Bean: Certainly, in terms of economic efficiency, less frictions are good but, clearly, we are now appreciating there is a potential trade-off here. If you want security, if you want resilience, then that may mean forgoing what might be the cheapest, most efficient trade connections, and that maps right back to a hit to GDP and all the things we know about. So I fully agree.

Q37 **Danny Kruger:** Should we adopt Jack's argument for the net zero policies, which is that investment in our domestic capabilities will have an economic benefit to us in terms of upskilling, in terms of capital investment?

Professor Bean: This would be where the new industrial policy comes in. There may be a dimension to that, but I would still think of that as being something which is an offset rather than enough to completely outweigh the adverse effects of essentially investing in resilience. From a welfare perspective, yes, it is the right thing to do, but it will have economic consequences.

Jack Meaning: Can I just come back on that in terms of the framing with the net zero thing? Obviously, those two things are independent of one another; you can build a more efficient domestic stock of housing and transition without there being some change in your international relationship. So, just to make it clear that actually those two things are independent of one another.

Q38 **Danny Kruger:** Although we could be making our own solar panels and wind farms rather than importing them?

Jack Meaning: That brings the two together, but it is not a necessary condition.

Danny Kruger: That is very helpful. Thank you; very interesting.

Q39 **Chair:** This has been an absolutely delightful luxury for us to be able to have such wisdom between the three of us today. If I may, I would like to indulge myself by asking a couple of further questions? In the second half of last year, the US economy grew by 3.8% while inflation fell. I just wondered if you would be kind enough to give us three main reasons why the US economy performed so much more strongly in 2023. Who wants



to start with that one?

Professor Bean: My take on this is that, superficially, it perhaps looks like the US, the UK, and the eurozone—let us include that as well—have all suffered from a similar inflation shock and have all raised central bank policy rates and so forth. Actually, what has been going on is slightly different in the three jurisdictions. The US is closer to a conventional cyclical overheating story. Leading into this episode you had expansionary fiscal and monetary policies; obviously, monetary policy moved restrictive, but fiscal policy stayed pretty expansionary. Importantly, in terms of trade shock from the rise in energy prices and so forth, although it has distributional consequences in the US and is bad for US consumers, the US is an energy producer, so was not made worse off by the consequences of the Ukraine war.

In the eurozone, you have something which is closer to a pure terms of trade shock with the rise in gas, oil, and food prices because quite a lot of that comes from Ukraine and so forth. We had the worst of both worlds. We obviously have EU-style terms of trade shock, but there is also a cyclical element, not particularly because of policy choices but, essentially, because of the loss of the half a million workers as a result of the pandemic, which meant we came out of the pandemic with a very tight labour market, essentially overheating, so it looks like the cyclical position you have in the US.

Q40 **Chair:** Net migration has been absolutely enormous in the last two years.

Professor Bean: Yes, but it does not alter the fact we have had a very tight labour market with vacancies at historical highs. Admittedly, they are coming down now and unemployment is relatively low. There are obviously question marks about exactly what is happening to the unemployment numbers, but it is clearly pretty low. Indicators of labour shortage still suggest the labour market is relatively tight. In those circumstances, labour is going to be able to push to get more compensation for the deterioration in living standards associated with the terms of trade shock and, indeed, what you see is somewhat higher underlying inflation in this country associated with somewhat faster pay growth here than in the US and the eurozone. In both those jurisdictions, the inflation shock is close to being over, particularly in the US. The EU has a little further to go.

Here in the UK it is less clear. Earnings growth in excess of 6%; settlements running at 5%. Jack's take is that we are going to see those rates come down swiftly, personally, I am less convinced about that. It is absolutely central to the degree of persistence of inflation going forward and, therefore, how long this mildly contractionary monetary stance needs to be maintained to squeeze the excess inflation out of the system.

Q41 **Chair:** Does anyone else have any other points about the US economy that have not been captured?



Nina Skero: I would have put all those points as the top three. The only thing I would possibly add is that we are seeing some fallout from the somewhat different approaches to spending during the pandemic. The US has spent a lot; the UK has spent a lot. In the UK, there was focus on welfare spending; I already mentioned the furlough scheme. The US has also spent a lot, but more so in terms of just putting money in people's pockets for them to spend. Having moved on from the pandemic, we are still seeing slightly different fallouts from how those spending packages were structured.

Q42 **Chair:** Thank you. Jack, do you have anything to add?

Jack Meaning: I would just build on what has been said. As Charlie said, it was an entirely different shock. Partly, I would say it was the terms of trade difference in nature, but also the UK is still working through supply side shocks that happened in the years leading up to and through the pandemic as well. Then, exactly as Nina said, a different response: we saw the US fiscal position push much more. That is what has essentially driven a different outcome, importantly for the consumer. If you look at consumer behaviour in the US, that is what has been driving growth. In the UK, if you look at private domestic demand through the second half of last year, for instance, it was contracting almost a percentage point, which is very different. The fact we were in a recession, even with the Government being the driver of spending in the economy, is because you did not really have that pass through to consumers. That consumer behaviour and the virtuous cycle it creates is a big part of the difference between the UK and the US.

Q43 **Chair:** Thank you. Just to let you into a secret, we had pencilled in Dr Bernanke for today to come and tell us what he had put in his report, and now we are being told we are not going to see that until mid-spring. Nina, we heard from you on the subject of the Bernanke review. Professor Bean, what are you expecting, and when and what has caused the delay?

Professor Bean: I have no idea what has caused the delay. I would assume that once he has written a first draft of his review, he will discuss it with the Governor and other members of the MPC.

Q44 **Chair:** What do you think will be in it? Dot plots, communication, a change to the COMPASS model?

Professor Bean: I spoke to Ben early on in his review and certainly gave my views of what I thought he ought to put in it. One thing I did argue would be a good idea—and since I am not the only person who suggested this, it would not surprise me if it does appear in the review—is a suggestion that the Bank should make more use of scenarios. The fan charts were obviously designed to try to convey uncertainty to the reader but, being honest, they have been a bit of a heroic failure in that the media, the markets, and your good selves, focus almost exclusively on the central projection. Particularly with the recent episode, there was a



high degree of uncertainty at the outset about how much persistence there would be. Central banks actually took the view there would be relatively little persistence and there has turned out to be more than there was. That could be not just talked about but illustrated with the aid of quantitative scenarios. So, that is one explicit thing.

It would not surprise me if he recommended more systematic exposed forecast appraisal and deconstruction—looking at forecast errors in the jargon. The OBR does this: it has an annual forecast evaluation report and recently produced a working paper looking at its track record since it was founded. To do that properly, you have to dig into how much forecasting errors are due to revisions in the data, inappropriate conditioning assumptions, faulty economic judgment, or just extraneous noise, which is quite a difficult thing to do. The Bank already does things like that internally. You have to do it when you are doing forecasts, but actually exposing that to the outside would be helpful in demonstrating the Bank is learning from experience and, therefore, it helps to build credibility.

Personally, I am not a big fan of dot plots. They have actually been a retrograde step in terms of communication. What you want central banks to do is be able to communicate their reaction function; that is what you need people to understand. Giving statements about the future path of interest rates, which are apt to be construed as being unconditional promises, is heading for a fall. The dot plots fall a little into that category. Instead, I would want to see the effort put into better communication of the reaction function; scenarios may be an ingredient of that.

I am sure he will also include stuff on how the forecast is conducted internally, the role of the model in that process, because, clearly, there has been a bit of a breakdown in terms of the confidence in the MPC in terms of the forecasting framework and its ability to be nimble in dealing with new problems and so forth. I am sure he will have some views on those aspects as well.

Q45 **Chair:** Thank you. It sounds like mid-April for us. Jack, anything else on that?

Jack Meaning: Coming back to Mr Kruger's point about this essentially being a broad remit: that is by far the biggest benefit of this. There are some deep questions that, hopefully, Dr Bernanke gets to about what the forecast is for: is it a communications device for the outcome of the MPC's view? Is it an input into helping it think about its view, or is it intended to actually be an accurate forecast of the future state of the economy? At the moment, it is probably trying to be some combination of all those things, and someone like Dr Bernanke coming in and asking those questions, helping give some guidance on those, is incredibly useful and will bring clarity.

Probably, one of the things that will be useful to see uncovered and which falls within the remit is, as I see it, the big tension in the MPC's



forecasting process. It comes around the fact you have individually accountable members with individual views on the MPC, but the forecast—as the Governor told the Committee yesterday—is the best collective judgment of those nine people. At best, that generates a forecast that, arguably, no one individual completely believes. At worst, it can drive internal inconsistencies in how that forecast then comes together, especially if you do not have clear views on what it is you are trying to aim for with that forecast. A case in point at the moment might be Catherine Mann’s view on the profile of wages which may be very different to Dr Swati Dhingra’s view of wages, but there is one path within the forecast that is the best judgment of both and represents neither. You need this review to uncover some of those tensions and come up with solutions.

Part of the potential solutions to that, as Charlie has said, are scenarios and simulations. A more extreme version that might be considered by Dr Bernanke but is by no means certain, I would have thought, is moving to a staff forecast. So, for people like me in the market, when we are trying to understand the individual MPC members, the key and all the interesting bits are in the differences in how they view the economy. A central view that we know none of them really believe is not much use for us to make our own predictions. So, a staff forecast independent of the MPC’s view could then focus on being an attempt at a good conditional forecast of the economy, and then MPC members individually could bring together their own views with scenarios and explain why they are different. For me, and markets more generally, that would be a very helpful innovation, and I hope it is under consideration by Dr Bernanke.

At the very least, I would expect discussion around how you bring out those differences, whether it is scenarios and simulations, or whether it is actually detaching the forecast completely. But, yes, I am looking forward to what he has to say.

Q46 **Chair:** Thank you; you have obviously all given it a lot of thought. Final question: it is the 21 March MPC meeting and you have a vote; are you going to hike, keep the same, or cut?

Jack Meaning: For me, I do not think it is clear cut by any means at the moment but, given our read on the economic data, if I were going with no history, I would probably be voting for a cut. Given the fact it is a long way from where the Bank’s communications are at the moment, I would take a meeting to point to the fact that cuts were coming and then, from May, I would start that cycle. In the scheme of things, six weeks may not be too much, it gives you chance to lay groundwork, but the economic data is pointing to a world where, in the next meeting or two, it actually justifies cuts.

Professor Bean: I would certainly be voting to maintain. I would not be thinking about voting to cut until there was evidence to sustain the idea that pay growth was decelerating to rates consistent with the inflation target. I cannot see any way that information is likely to be available



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before the May meeting. You basically need to go through the pay round this year where the concentration of settlements is January and April.

Nina Skero: I would probably go for a dovish hold, so voting to hold but giving some indication in the communications that in the coming months, if the signals are right, I would be open to vote for a cut.

Chair: Do my colleagues have any further questions? No? Then, it remains for me to thank you so much for a very interesting session. We really appreciate your time this afternoon.