

Treasury Committee

Oral evidence: Autumn Statement, HC 826

Tuesday 10 December 2013

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Members present: Mr Andrew Tyrie (Chair), Mark Garnier, Andrea Leadsom, John Mann, Mr Pat McFadden, Mr George Mudie, Mr Brooks Newmark, Jesse Norman, Teresa Pearce, John Thurso

Questions 76-144

Witnesses: **Brian Hilliard**, Chief UK Economist, Societe Generale, **Alan Clarke**, Director, Fixed Income Strategy, Global Banking and Markets, London Scotiabank, and **Melanie Baker**, Vice Chairman, UK Economics, Morgan Stanley, gave evidence.

Q76 Chair: Thank you very much for coming to give evidence to us this morning on the OBR forecast and the autumn statement. Melanie Baker, we have had six months good data and it does seem that a number of people are telling us that we have a recovery that we can now feel is reasonable assured and rolling out. The OBR is forecasting 2.5% growth on average through the forecast period annually. How confident are you that this recovery is deeply entrenched and why?

Melanie Baker: I am confident it is sustainable, partly because I think it makes sense for the UK economy to be doing better now. Fiscal austerity is dragging a bit less this year. The external environment has improved, so the Eurozone is a bit more stable. That is important for business confidence and for the banks as well, of course. We have also seen a dramatic improvement in credit conditions. All these things mean it makes sense for the UK to be recovering. I would expect those things to persist as a central case. I think what would make me more confident in—

Q77 Chair: The credit conditions have been good for some time, haven't they?

Melanie Baker: Since summer last year they have been gradually improving. We have seen lower mortgage rates coming through. We have seen credit availability improve. It has been in train for a number of quarters now.

Q78 Chair: 18 months.

Melanie Baker: Yes.

Chair: I am just trying to pin down how much confidence we should have in this six months of good data.

Melanie Baker: I think it makes sense to have confidence that what we are seeing is real. It is not just a blip in the data. If I look across a broad swathe of data, you can see things happening across different sectors. Manufacturing is picking up. If you look at PMI surveys and things, business services are picking up. The pick-up in construction is not just residential. It would give me more confidence if we saw a better balance developing. I am

hoping that next year or the year after we will see more business investment; a better contribution from net exports, for example.

Q79 Chair: We will come on to that in a moment, but what I am trying to get a reply on is, given what we know at the moment, are you confident that a return to trend growth or possibly even higher than historical trend growth over the forecast period, which is what the OBR has forecast, is what is going to happen or are you more confident in some other outcome?

Melanie Baker: I am confident that we are now in a sustainable recovery. I am not sure that my forecasts for the longer term would be quite as high as the OBR's.

Q80 Chair: Okay, just translate that. You would have a lower forecast?

Melanie Baker: Yes. We think longer-term trend growth now in the UK is probably around 2.25% to 2.5%, rather than 2.5% to 2.8%.

Q81 Chair: But you do think that they are right to conclude that we are returning to trend growth?

Melanie Baker: We are returning to better growth, yes.

Q82 Chair: No, not just a better growth. Everybody has agreed there might be some pick-up. I am trying to get to whether you think basically we have come out of this set of problems and we are returning to trend, which is what the OBR has forecast.

Melanie Baker: Yes.

Chair: You are?

Melanie Baker: Yes.

Q83 Chair: Your reasons for that are primarily these surveys and you are happy to hold that view even though you do not have the evidence from, for example, the pick-up in investment that will bring growth?

Melanie Baker: Yes, as a central case and everything that I have seen so far makes sense, but clearly there are things I would like to see developing over the next couple of years to give me more confidence.

Q84 Chair: Mr Clarke, can I ask you whether you think it is reasonable to suppose we can return to trend growth while, at the same time, most people agree that the personal sector needs to rebuild its savings?

Alan Clarke: The angle I come from is it is normal to grow unless you have a countervailing influence holding you back, which we have had over the last year with tight credit conditions and headwinds from the Eurozone. It is normal to mean revert and what is the normal growth rate now? My view would be around 2% or maybe slightly above that, but we have many years to go of fiscal austerity applying a brake domestically. Externally we have the brake on growth in the Eurozone from our biggest trading partner. We should move back towards trend growth, but there are a couple of headwinds getting in the way of that. The flipside is that we do have this boost coming from the housing market. Rightly or wrongly—

Chair: We are going to come on to that.

Alan Clarke: Sure.

Q85 Chair: If I may, I will cut you off there but I do want you to say something about the relationship between recovery in savings and the growth rate, which we did not seem to get an answer from the OBR about yesterday. The question is, logically, would you expect growth to be below trend while we rebuild our savings or not?

Alan Clarke: Yes, we should expect it to be below. At the moment we are seeing the opposite, people running down their savings. You have the combination of wage inflation and employment growth roughly zero, but people spending two to two and a half percentage

points more per year. So we are seeing a running down in savings in that regard because the money has to come from somewhere, either running down savings or increasing borrowing.

I have been speaking to the biggest building societies in the country over the last day or so. They are not chiming with this report we saw from the Bank of England. They do not have a problem attracting new deposits coming in. In actual fact, they have been, reluctantly, cutting their savings rates because they have so much cash coming in they do not know what to do with it. I think there is a mismatch in the data somewhere, but that is the near term. Over the coming years we should see a building up in savings and that will hold us below medium-term trend numbers.

Q86 Chair: Therefore, you do not have confidence in the OBR's central forecast of 2.5%, do you?

Alan Clarke: I am nervous about 2015. I agree with their near-term optimism. I think we have this momentum from the consumer, but in 2015 they have Government investment and Government spending cooling off and if anyone should know about those figures it is the OBR. Where I am more nervous is the sugar rush from the housing market and the consumer gets tired legs. If we get the combination of the OBR's pessimism on Government spending and my pessimism on the consumer taking a breather, 2015 could be somewhat slower but still not disastrous. Still in the 1% territory, not back to the near zero that we were six to 12 months ago.

Chair: Mr Hilliard, do you want to add anything?

Brian Hilliard: Yes, thank you. In the short-term, of course, we are going to grow above trend because we are seeing such strong momentum in the quarterly data—business surveys as you say, but also the official data. There is no reason to see a sudden reversal of that momentum. Of course, I also think it is important to put this against the backdrop of very loose monetary policy and we are perhaps little bit too ready to say that the Bank of England will not keep rates low for quite a long time. I think that is going to help. We are seeing a suffusion of well-being. Improved confidence in the economy, consumer confidence in particular is improving, and I think that will be helped by the housing market and I know we are going to come on to that further on.

Chair: We are in a minute.

Q87 Mr Mudie: I would just like to go over the questions again that the Chairman put. Conventional wisdom has it that the present growth or present improvement is based on consumer spending and housing. How sustainable is that, because the OBR seemed to suggest that next year that would start to fade?

Melanie Baker: In terms of what we have seen so far, I do not think it is all about the credit-fuelled consumer and all about housing. Again, if you look just beyond the expenditure GDP data to the broader survey data and the wide range of UK data, the recovery does look broader than that.

Mr Mudie: I felt from the OBR's figures those were the two areas that showed real improvement and, therefore, pulled the figures up.

Melanie Baker: If you look at the expenditure data on the GDP side, if you look at the output breakdown, manufacturing has picked up. Construction has picked up. Broadly, services have picked up and the services pick-up isn't just about the retail element. Business services have picked up, too.

Q88 Mr Mudie: If we take those two as being the leaders and, as the OBR said, because the consumer spending is either using savings up or credit, that would suggest that element could be short-lived.

Melanie Baker: Going forward you do want to see a better balance of growth on that expenditure data.

Mr Mudie: You are dropping again. I can't hear you.

Melanie Baker: When you look at the expenditure data, you would want to see a better balance as you go through the next year or two. That is absolutely fair. To be confident in the sustainability that is something important to see. Even on the consumer front I think you would want to see is a pick-up in pay growth so you could also be confident in the sustainability of a reasonable pace of consumer spending growth as well.

Q89 Mr Mudie: You would like to see that, but if you do not get that?

Melanie Baker: Then I would be more worried about the sustainability.

Q90 Mr Mudie: What would be the difference if it were business investment led and net trade led?

Melanie Baker: It is just a better balance.

Mr Mudie: A more sustainable balance?

Melanie Baker: Yes, a more sustainable balance.

Q91 Mr Mudie: Yes, all right. I think you have read it better than me, but as I read the OBR they seem to suggest that the consumer stuff will fade but be picked up with business investment and net trade improvement and that will sustain the improvement. Is that automatic or is that a projection based on some underlying features that are happening now?

Melanie Baker: From the OBR perspective it is largely a projection but based on some things that are developing. I think of my own forecast where I am looking for an improvement in business investment, as the OBR are. Some of that is about the fact that credit conditions have improved. It is about a lower level of uncertainty and lower tail risks in the euro area and higher business confidence, of course, which we have seen. It should all feed through into strong business investment.

Q92 Mr Mudie: Mr Hilliard, are you confident that business investment will start improving and, if not, how do you suggest you can stimulate that start?

Brian Hilliard: I am reasonably confident it will recover within the next year or two. I think it is surprising that we have such a disconnect between fairly positive business surveys and the weak official data and the Governor of the Bank of England has highlighted that. It is not just a UK issue. It is something that is general to the industrialised economies. We have had a cash-rich corporate sector that I think has been restrained by lack of visibility and demand and I think the conditions are falling in place for that to improve. Domestically certainly we are getting this increase in consumption from whatever source, but internationally we are getting some reduction in the uncertainty in the Eurozone, which I think is a very important backdrop for an improvement. One can't be precise on the timing, but I think the conditions are in place for investment to pick up. I would not suddenly say they are going to leap up within the next six or nine months, but they should be recovering.

Q93 Mr McFadden: We had Robert Chote in yesterday and his colleagues from the OBR and I asked them to locate the slump in the current recovery historically compared to previous recessions. I want to start with you, Mr Hilliard. Mr Chote said that the depth of the slump had not been historically unusual compared to previous recessions, but what had been unusual was the length of time it had taken before recovery began. Looking at the Government's fiscal stance, do you think austerity helped the recovery or delayed it?

Brian Hilliard: I think it was broadly correct and I hope this was what I was saying when I appeared before you a couple of years ago. I think it was necessary to demonstrate to the international markets at that time that we had a credible medium-term policy to get the

deficit into surplus. It is easy to forget that at the height of the crisis our deficit was 11% of GDP. Everyone says what a mess the Eurozone was. Spain had a deficit of 11% of GDP. These are absolutely colossal numbers and we could not have just sat by and said, “Well, everyone is in a mess. We shouldn’t try to repair things”. We had to do that and I think we received the benefit of that in terms of low bond yields. That was, in itself, a monetary stimulus and it was the absence of some very destabilising shocks that helped.

Alan Clarke: If you look at the progress on the structural deficit, that has narrowed by about 0.5% per year over the last two years. Economists typically apply a fiscal multiplier to that of around a half. If the structural deficit narrowed by 0.5%, the drag on growth has been about 0.25%. I think that understates the headwinds to the economy because I think there is the psychological impact. The wider population has seen austerity. The VAT hike has hurt people in their pockets, with less disposable income. In terms of the maths of what typically is narrowing the structure of the deficit, it suggests it was the lesser of two evils and the bigger evil was our biggest trading partner, the Eurozone, not only not sucking in our exports any more but also at serious risk of imploding. I think it was the confidence effect of that coupled with the confidence effect of austerity rather than the direct effect of austerity that hurt.

Q94 Mr McFadden: Do you share Ms Baker’s confidence that the current recovery is sustainable and it will not run out of steam?

Alan Clarke: For the next year to year and a half, absolutely. It is not that we are growing that fast. If you look at the survey-based indicators, if you believe the PMIs at face value—

Q95 Mr McFadden: That is in the last five or six years.

Alan Clarke: Anything is better than nothing, but if you took the SIP surveys at face value you could argue growth between 1% and 1.5% quarter on quarter. Currently we are getting 0.8% and the OBR sees 0.7% in Q4. That is okay, but it is nothing like what the surveys show and perhaps the surveys have risen through relief that the worse-case scenario is not happening rather than a tangible improvement. It is not that we are absolutely booming and at risk of falling off a cliff. I think, absolutely, we can continue to grow. The 0.8% now, this is probably as good as it gets. Well, we have the pent up demand of a couple of years of real panic. Then the 0.5% quarter on quarter that the OBR has over the following year or so, absolutely. That is 2% annualised and if you compare the counterfactual of where we were six to nine months ago, it absolutely would have taken 0.5%. I think if investment stops shrinking and starts adding to growth and the Eurozone stops shrinking, we can get there.

Q96 Mr McFadden: Ms Baker, economy saved or recovery delayed. Where do you stand?

Melanie Baker: On the fiscal consolidation?

Mr McFadden: Yes.

Melanie Baker: I agree that it was necessary, but has it dragged on growth? Yes, clearly it has over the past couple of years. If I break down what is under departmental budgets and the particular budget decisions, in our calculations it probably dragged on GDP growth by about one percentage point up, maybe a bit less, up until last year and this year it has been dragging less on growth.

Q97 Mr McFadden: I want to look forward a little bit now to the shape of this because a big message from the Chancellor is we cannot relax, we have to keep up with fiscal discipline going forward and so on, but some commentators have drawn attention to some apparently unfunded or at least very sketchily funded spending promises in the statement last week. I am reading here from the opening remarks from the Institute for Fiscal Studies in

their post-autumn statement round-up and they say that the tax cuts on marriage allowances, employers, National Insurance, fuel duties and so on add up to about £2.5 billion, “These are only partially offset by £500,000 from the increase in bank levy and by a rather sketchy building or social monetary avoidance measures.”

They point out that the free school renewals policy, which costs £750 million, is just to be absorbed into departmental spending after the first couple of years and that there is an assumption of nearly £4 billion a year in additional National Insurance payments from public sector employers. All of these things, rounded up, add around £7 billion of additional spending pressures from 2015-16. Looking at these individual measures and how they are funded or not funded in the future, are you confident that the measures announced are balanced by the savings necessary to make them work well or is this fiscally neutral or is the Chancellor taking his foot of the gas a little bit? I will go the other way this time. Ms Baker, can I get your view on that first?

Melanie Baker: I do not have a strong take on that for this specific autumn statement. There are some things that may not come through as savings or may not come through as strongly as expected, on the tax avoidance side for example, but, equally, some of the investment plans may come through a little bit slower than expected. I do not have a strong take.

Alan Clarke: The measures I would be most nervous about would be the anti-avoidance. This is an exaggeration but if you took budget after budget over the last several years, we would not have a deficit at all if they were all as effective as they promised. That is probably a bit harsh, but that would be the one I have most doubts about.

Brian Hilliard: I think generally you are expecting too much precision from medium-term financial forecasts. £7 billion is a lot of money, but in terms of the precision of the forecasts it is noise. There may be some further share sales that could fund it. Who knows what the Government has in mind. The precision on the forecasting and the precision on the individual measures is important but it is difficult to know.

Mr McFadden: Your message is do not worry too much about making every dot and comma at least in advance?

Brian Hilliard: Indeed, yes.

Q98 Jesse Norman: Mr Hilliard, just to be clear, do you share the view that the economy is going to return to trend growth?

Brian Hilliard: I think the trend figure moves. Over the next two or three years a maximum of 2% is what I would expect for trend. Maybe the following three or four after that it may get back to the sunny uplands of 2.25%. In the short-term it is certain to be above that and, as I said at the very beginning, I think the momentum of the economy is easily going to take it well above that number. Further on there is still the challenge. The balance of forecasts from the OBR, I think someone said earlier that there is a significant contribution from net trade. I do not think that is right. I think the table shows virtually nothing. It is mostly domestic.

Jesse Norman: The key point is we are in this looking glass world where we all agree that it gets back to trend, but no one can agree what trend is.

Brian Hilliard: Let us be honest, the economics profession should be extremely humble about its ability to forecast or rather not forecast in this recession. We also are all very pleasantly surprised about this sudden bringing together of circumstances that is giving this sweet spot of growth. Did we predict this particular quarter that was going to happen? No, we did not. We can present you some reasonable explanations of why it is happening now, but we have to be cautious in that.

I think the basic point I would make about trend growth is that there has been a set of circumstances that have credibly lowered trend growth in the next three or four years because of damage to the desire of banks to lend, damage to the ability of banks to lend in terms of having to rebuild their capital base, and a natural caution on the part of businesses. All these things have reduced trend growth in the short term.

Q99 Jesse Norman: That is helpful. Thank you. Ms Baker, on the savings ratio, the OBR is forecasting that the savings ratio is going to decline from 5.5% to just under 4.5% over the next five years. Do you share that view?

Melanie Baker: Yes. Our forecast would be that the savings ratio does come down somewhat.

Jesse Norman: Is that a concern to you?

Melanie Baker: Partly it is about what is driving it. One of the reasons why the savings rate went so high was clearly we had a big increase in uncertainty, unemployment figures surged and there was a credit crunch. To the extent all those things are unwinding and that helps justify a decline in the savings rate, it does not necessarily have to be worrying.

Jesse Norman: But it looks like what is happening is that people are spending more. There is higher consumption and that is accompanying falls in the savings ratio. What are the factors that are driving those trade-offs?

Melanie Baker: For the near term it is partly about pay growth. We have very weak pay growth in the UK. Households tend to smooth their consumption to an extent. When you have blips in pay growth you naturally get some of these things happening in savings rates. My assumption is that pay growth does pick up and that is partly perhaps why I would not necessarily be worried if the savings rate comes off a bit.

Q100 Jesse Norman: Do you think it has anything to do with monetary conditions?

Melanie Baker: To the extent that loose interest rates are low, it is a disincentive to save. That is going on in the background, but for me it is not playing a big role in what we have seen in the last three or so quarters. The fall in the savings rate we did see as partly about the pay growth.

Jesse Norman: I do not understand that. Surely the whole point of QE is to bump consumption up. It is to pull spending forward. Does this show the policy is working or does this show the policy is mistakenly targeting something where the savings ratio ought to be an object of policy instead?

Melanie Baker: Monetary policy is clearly helping the general backdrop and so there is lesser uncertainty, but credit conditions is partly a function of what monetary policy has done. Yes, it sort of fits.

Q101 Mark Garnier: Mr Hilliard, can I take you to the other side of this household savings equation, which is household debt. I do not know if you saw yesterday's session with the OBR. We discussed this at length with them as well, but the reason I turn to you is perhaps because you are the oldest and have more grey hair of the economics in front of me.

Brian Hilliard: Thank you for that.

Mark Garnier: Therefore, you will have more experience of occurrences in bygone days. Certainly when you look back to the boom of the 1980s we saw household debt rise as a percentage of gross debt to income ratio. We saw a rise from 70% to 82%, so there was a 12% increase in household leverage, and yet in the 10 years leading up to the financial crisis we saw that same measure increase from about 100% to 170%. My question to you is slightly more philosophical. Given that you have seen quite a long period of economic development over 20, 30 or 40 years, do you think we are in a healthy position now where we still have

household debt at around 140% of household income or do you think we have now reached some new paradigm when everybody seems to think this is perfectly acceptable and there is nothing to worry about?

Brian Hilliard: A very good question. Firstly, on the facts, I think the peak was about 154% not 170%. Were they the disposable income numbers?

Mark Garnier: According to the OBR, I think there is a chart on page 70 of their report, but it also depends which—

Brian Hilliard: I defer to the OBR, but it has come down in the last few years. If you look at a long-term chart, you had a period of stability, maybe two decades. Then it rose a lot, as you say, and now it has started to come down. It is very easy to say, “Well, to get back to a balanced structure you want to get back to those previous decades where it was less than 100%”, but what that ignores is that the interest rate structure of the economy has, I think, permanently changed.

We were living with very high inflation rates and nominal interest rates responded to that and that meant that the debt service cost was correspondingly high. Now we are in a world, for the next five or 10 years at least, of very low interest rates and that means that debt serviceability has improved because the interest payment is much lower. I do take the point that in the medium term that level of debt as a percentage of disposable income should come down, but I do not think we should feel that it has to go all the way back to the norms of, say, 30 years ago.

Q102 Mark Garnier: That is a very fair answer. The problem is the OBR is predicting this to go from 142% in 2014 up to 160% and that is going to be at a time when we know that interest rates are going to be going up. Of course, it is one thing if interest rates go from 12% to 15%. Horrific though it sounds at the time, it is not a very significant increase in your funding cost of debt. If the base rate goes from 0.5% to a traditionally low level of interest rate, let us say 3%, you have had a six-fold increase in funding costs. One of the problems with being in a super-low interest rate environment, the lowest for 300 years, is that it does not take a very big movement, in terms of numbers of basis points movements, in order to have very a dramatic effect on the funding cost.

There are a couple of questions. Let us start with the first one, which is do you not think that households are now in a rather relaxed attitude to debt and that could be hiding underlying instability of households that, when interest rates do inevitably go up, could suddenly force out huge amounts of problems?

Brian Hilliard: I do not think households are relaxed about debt. I think it is very much a distributional thing. Some people suffer very badly and others have come out of the crisis okay. There are ways of insulating yourself quite easily against the increase in interest rates and the obvious one is to take out a fixed-rate mortgage. As a common product, that can be up to about five years and those interest rates are very attractive at the moment. That will delay the impact to some extent and if the economic recovery beds down then income will pick up and people will be able to afford that more easily, so I think there are mitigating circumstances.

The other point, of course, is that from a policy side forward guidance, in Mr Carney’s words, is talking over the heads of us clever guys in the financial markets to the man and woman in the street and telling them that interest rates are going to remain low. That is encouraging people to take more mortgages in the short term. We have to change the balance in the medium term. There are so many clear imbalances in the economy, domestic as against external and within domestic it is investment against consumption.

I would like to pick up on an earlier point about QE. QE was in no way designed to simply drive consumption. It was a massive leap into the dark to try to stabilise an economy

globally that had just frozen. I think it was the right move, but it was not primarily aimed at consumption in the short term.

Q103 Mark Garnier: Sticking on debt, although it is a very interesting point about QE, the reality is that the numbers in absolute terms have stuck fairly rigidly at the £1.45 trillion or thereabouts mark and the reason it has come down in terms of the ratio is because household income has gone up, as more people have gone into work and people get paid more. The problem is that the OBR is now predicting that it is going to go up again. So household debt is going to go up at a time when household income is growing. The number has to be going up at a far quicker rate than the household income is in order for that leverage ratio to go up. You are mathematicians and you understand this. Is it not a problem, though, that we are getting to a stage now where we require households to increase their leverage in order to get any economic growth given the fact that household consumption is 60% of GDP?

Brian Hilliard: Yes, it is and clearly the increased desire of households to take on more debt is a function of the improvement in consumer confidence that is at least generated by the housing market. I do get uncomfortable seeing that so much of the improvement in the economy in the next year or two is built on the housing market.

Q104 Mark Garnier: I have not spoken with your two colleagues. Do either of you feel in the slightest bit worried about the fact that households are revving up their balance sheets again?

Alan Clarke: I am uneasy that at the moment 70% of outstanding debt is linked to bank rate. Clearly, a few years ago it was the other way round. You had more fix and less floating, but it is much easier to revert from a fixed rate mortgage or a legacy tracker on to a lender's standard variable rate. It requires zero effort, but inertia holds people back from digging out their bank statements, payslips and so on and there are fees to get on to a new fixed rate product. That requires effort. I agree with everything Brian says. There is the opportunity to lock into low fixed rate deals, but we see inertia in a number of areas of the economic data. It makes me slightly worried that if leverage ratios go up there is time bomb ticking. If you go from a bank rate of 0.5% to 3%, in outright terms that is still a very low level but that is an enormous hit on household disposable income and their ability to finance their debt obligations.

Q105 Mark Garnier: There is some quite scary data on household vulnerability. There was a report recently that talks about households have less than 18 days of savings before their reach crisis if they lose their income and I think 40% of households can't pick up a £300 unexpected bill. They can't service their car, for example. This does not create a happy picture of households that are getting themselves ready for a rise in interest rates.

Melanie Baker: I think you need to see that pay growth come up and incomes improve. I know one of the things that MPC members often say is that they will look at incomes when they are thinking about whether to raise rates or not. That seems to be implicit in what they have been saying. I think that is important.

Q106 Teresa Pearce: I would like to talk about housing, not just home ownership but rents as well. Britain has a housing problem. How much do you think that is down to under-supply?

Melanie Baker: There is clearly an issue. If you look at Government projections of household formation and where it should be coming in giving demographics and things, it is clearly quite a long way above how many households are forming. There has been a lot of

work done in the past on housing supply and responsiveness and clearly there is a need for more housing in the UK.

Q107 Teresa Pearce: Do you believe it is a problem with supply rather than cost of housing or both?

Melanie Baker: I suppose both, but certainly supply needs to come up and we would expect supply to be coming up over the next couple of years.

Alan Clarke: I have not looked at things recently, but in the last couple of years we were not building enough homes to keep pace with the growth in household formation. We have migrant workers potentially coming from Bulgaria and Romania and that will only intensify. Demand clearly fluctuates, as it would do. Supply has been lacking and you can see this in the Royal Institute of Chartered Surveyors survey out overnight. In the deepest recession since the war prices went down, but not nearly as much as they could have done because supply just was not there. There was not the excess supply and maybe that saved us from an even worse downturn, but clearly it did demonstrate we do lack supply.

Q108 Teresa Pearce: What do you think the cause of under-supply is?

Alan Clarke: We are a small island nation. There is the NIMBY thing, people not wanting eco-towns anywhere in the vicinity of their homes. Maybe that gets in the way of it—planning. Ultimately, we are a small island nation and there is only so many houses you can build on the land that we have.

Brian Hilliard: We are a small nation, but whenever I fly over everything looks almost green, which is rather nice, outside the cities. I think it is a planning constraint and I think it has been in place for a long time. Obviously very worthy attempts are being made to try to relax those in a sensible way, but certainly what we are seeing in the short term is that the stimulus from policy is driving up demand more quickly than supply. That is why we are seeing such a sharp acceleration in house price inflation and I think we should expect that to continue in the short term. It is very uneven. I think we tend to colour our judgment by being seated in London and seeing the very sharp increases in prices here. Some regions are not experiencing price increases at all yet. They will, but it is a demand-led story that is going to bring forward some supply but I am not confident it will bring forward enough supply to level prices out quickly.

Q109 Teresa Pearce: At the moment we have a lack of supply. So if the supply increases that is all very well, but if the supply increases and all the houses to rent or buy are too expensive then that is not going to alter anything, is it? The OBR believes that house prices will rise by 5.2% in 2014 and 7.2% in 2015. Does that tally with your projections or do you think it is too variable across the country?

Brian Hilliard: It seems a reasonable set of forecasts and it could even be higher than that.

Teresa Pearce: It could be higher?

Brian Hilliard: Yes.

Alan Clarke: I would be more bullish. Given where the Royal Chartered Institute of Chartered Surveyors survey is, we are looking at double digits within the next six months. At this point in the cycle, when you have had that survey as high as this and the PMI surveys as high as this, we have had several interest rate hikes from the Bank of England that we know are not coming very soon. So there is nothing to put the brakes. I certainly think we will be in double digits. Admittedly, their forecast is an annual average. At some point household inflation will be above that, but I would be—

Teresa Pearce: The survey from the Royal Institute of Chartered Surveyors was a survey of surveyors who are at the coal face. They are looking at house prices and property prices. That is more likely to be nearer the truth, I think, than the OBR's forecast.

Alan Clarke: There are leads and lags. The RICS survey leads by about six months and it has been six months since it skyrocketed. At the moment the ONS measure is showing house price inflation at about 3.3%, but we are at that six month time when that should start to pick up. That is sampled further down the line.

Q110 Teresa Pearce: But the OBR's estimate did not take into account the changes to Funding for Lending. Do you think that would have an effect at all on their estimates?

Alan Clarke: I do not think so. Certainly talking to the lenders in the UK, they do not seem too disturbed by it. When it was first introduced it was supposed to be up to £80 billion in size. The take up has been around a third of that and, implicitly, it has been the backstop provided by the Funding for Lending Scheme rather than the tangible use of it that has unlocked the wholesale financing market so lenders can issue debt in the wholesale markets.

Q111 Teresa Pearce: Brian, you mentioned regional differences. Clearly, London is a hotspot and one of the announcements is to make non-residents liable for capital gains tax. Do you think that would dissuade foreign buyers from buying up properties in London and raising prices?

Brian Hilliard: It will obviously have an effect at the margin, but if it is flight capital then I do not think they are going to be worried by the size of the tax increases that are being mooted. I would also make a very important point about these RICS surveys. They are the timeliest. They are very widespread in their coverage, but they do not translate directly into official price data. You can draw any number of charts showing the price index from the RICS in trying to look at the price index compared to the house price index from the ONS and it does not match. It gives you trends. It gives you early warnings, but it can exaggerate.

Q112 Teresa Pearce: We were told one of the reasons for the Help to Buy Scheme being brought in was that it will allow first-time buyers to compete with Buy to Let buyers and that means that people can get on the housing ladder rather than renting, yet rents continue to rise despite increased supply. In London, for instance, in the last 10 years there has been a 75% increase in supply of rental property and yet rents rise and rise and rise; 9% just in the last year. Supply of houses to buy may make a difference, but supply of houses to rent makes no difference in rising rents in London. What do you think could bring down rents in London? Nothing?

Brian Hilliard: One of the factors in the short term was that there was a whole generation of buyers not able to enter the housing market during the early stages of the crisis. They had no choice but to rent. That pushed up rents artificially. As you are seeing people return to the housing market to buy that will—

Q113 Teresa Pearce: But why did it push up rents?

Brian Hilliard: Because they had no choice but to rent rather than buy.

Teresa Pearce: If they had no choice other than to rent but there was a massive increase in the supply of rentals, why does that push up rent?

Brian Hilliard: Because the demand was increasing even more.

Teresa Pearce: Even more than the supply?

Brian Hilliard: I think so, yes.

Q114 Teresa Pearce: When people are priced out of the housing market the rental market surges. We also have a situation now with Help to Buy. In London people are waiting

for the beginning of the year when they can get the Help to Buy a mortgage but they are already sort of warehousing people in the applications. Every indication from every estate agent and every agency is that house prices are going to go up rapidly next year, so we are going to have pressure on purchasers and pressure on rentals. Where are people meant to live? Do you have any forecasts for increase in house prices in London and the regions? Do you think it will just be a London bubble problem?

Brian Hilliard: No. Historically, these higher house price inflation numbers start in London but they are transmitted to the regions and very often the final peak is higher in the regions than it is in London, which is a strange thing to observe but it does happen.

Q115 Teresa Pearce: One last question. Do you think rising property prices are good for the economy?

Brian Hilliard: At some points, not necessarily now. The policy response of the Government with Help to Buy has been to try to close that gap on loan to value ratios. I think, in a structural sense, it would have been better if we could have seen a larger fall in house prices to improve the affordability in a more sustainable way.

Teresa Pearce: Alan, do you think they are good for the economy?

Alan Clarke: Notwithstanding some of the risks we are facing, certainly looking at the counterfactuals, six to nine months ago you could have argued zero growth this year and we are not seeing that. We have seen 1.5% growth this year and 2.5% next and that is in no small part due to housing. I accept it is risky. I accept it is housing that got us into this mess, but we are in a situation where we are growing and employment is going up. We stand a decent chance of wage inflation picking up and recovery becoming self-sustaining. I admit it is risky, but I would rather be in that situation than sitting here saying, "There's a good chance of zero growth or recession".

Melanie Baker: Higher house prices should translate into higher growth through more transactions, wealth effect, more collateral effect, in theory yes. You certainly would not want it as the sole source of growth, of course.

Teresa Pearce: But you think rising house prices are good for the economy?

Melanie Baker: In theory there should be a positive effect.

Q116 Chair: You seemed to be suggesting, Mr Clarke, that it is healthy to prime the economy with housing. Therefore, you must have a lot of confidence in the ability of the Bank of England to choke this off with their new powers. Is that correct?

Alan Clarke: I do. Having seen upturns and downturns in the housing market, housing has led the overall economic cycle.

Chair: That bit we all agree on. It is the choking it off. It is the taking away the punchbowl point that we seem to have failed to manage, historically, in Britain for the whole of the post-war period.

Alan Clarke: I remember in the last boom, so to speak, where there was only a token 25 base point rate cut and the housing market took off again into double digits, what was a catalyst for that was five times incomes multiples on mortgages. The Bank of England did not have the tools to control that then. It probably has more ammunition now to tinker with that to specifically address the housing market rather than hurting the wider population through higher interest rates and hurting recovery.

I am confident. I think they have better tools now, even token gestures like removing the extension for the FLS for mortgage lending from January. It is symbolic. It is all over the newspapers, but what better opportunity did they have? We would clearly have had shrinking consumer spending growth this year had the housing market not taken off.

Q117 Chair: This has a lot to do with consumer confidence, doesn't it; the relationship between consumer confidence, consumer spending and housing. I find it a bit curious that you have so much confidence in the Bank of England on this, given that you are saying that the forward guidance has had this big impact and the public have been able to read the rumours about that, but Mark Carney is out there today trying to warn about the housing market and he has already been at it for some weeks. You have mentioned Funding for Lending. Doesn't there seem to be a bit of a mismatch between one group of things he says that have a big impact and another group of things he says that seem to not be being heard at the moment?

Alan Clarke: In the absence of forward guidance, I think you would have several forecasters looking for interest rate hikes within months given where survey indicators are in the housing market. I do not know of any forecaster going for a rate hike this side of the end of 2014, so it has worked in that regard, but the market is delivering some tightening on behalf of the Bank of England. In Mervyn King's old Maradona theory style, the pound has appreciated. I would not be surprised to see mortgage rates starting to rise, certainly if you see people switching from legacy standard variable rate mortgages into fixed rate mortgages. That will automatically, to some extent, put the brakes on without the Bank of England needing to lift a finger, but I do think the macro-prudential policies will at some point have to come in if the housing market does not slow of its own accord.

There is an element of pent-up demand of three years and that will get tired legs. I think you have new supply coming on from Help to Buy. It is a slow process. You also have people who may have bought a house at £200,000, the price dropped to £150,000 and they were reluctant to sell at that point and crystallise a loss. Now that house prices are getting back to where they were I think you will see more supply of legacy owners coming back on to the market and maybe giving an automatic stabiliser.

Q118 Mr Newmark: The OBR has argued that private investment is expected to make a growing contribution to nominal GDP growth as usual during a recovery, with its share of nominal GDP increasing from 11% in 2013 to just under 15% in 2018. Given that we did not have a normal crisis and the recovery has been delayed, why should we expect private investment to increase as the OBR suggests?

Alan Clarke: I think there are good reasons why investment has been weak. As a ratio to nominal GDP, it is the lowest since at least the 1950s if not further back. Why is that? You have to deliver a certain amount of investment to make good on depreciation; logical things like businesses replacing their company car pools after three years rather than two, replacing BlackBerrys, laptops and things like that. While there was nervousness about the Eurozone and so on over the last year and there was every reason to delay making good on depreciation, we cannot keep shrinking at 10% year on year forever. At some point that must snap back to zero and will give you an add to economic growth.

You also have to ask yourself, if you are a business, why you do invest. You must expect someone to buy the things you are producing. If you are an export-facing producer delivering to our biggest export markets in the Eurozone and they are not growing, there has not been that incentive. There is light at the end of the tunnel that the Eurozone will begin to recover, belatedly. Not rapidly, but there is that glimmer of hope that if you are investing for the export-facing industries that could get better. For domestic-facing industries, absolutely. Now domestic demand is doing better there is also that glimmer of hope.

It is a bit of a lagging indicator but, typically, when this ratio has been as low as it has been you have had a decent recovery, but you could have argued that four years ago, admittedly.

Q119 Mr Newmark: You are optimistic going forward?

Alan Clarke: I think so. Construction was an ideal example, this time a year ago shrinking by 10% year on year and now it is flat to positive. I think you could have a similar thing with business investment.

Q120 Mr Newmark: If we strip out construction because that has had an extra stimulus, looking at the rest of business out there, do you think that confidence is there; that they are going to start continuing to re-invest or up the ante when it comes to their investments?

Alan Clarke: Compared to where we were, yes. If you believe the Bank of England survey that previously more than 50% of businesses were not keen to invest because they were nervous about the economic outlook and now they say that 5% of businesses responded that they were nervous because of the economic outlook. That impediment has gone away to some extent, but it ultimately comes back to why you would invest. You have to expect an end buyer to buy your goods.

Q121 Mr Newmark: You could say, because there was no business confidence, people were pulling in their horns. They were effectively de-stocking and using up their inventory and now they are running on air, you could argue. Therefore, they are starting to reinvest, starting to buy things up to restock their inventory. I am just curious. Is the increase more than what one might expect in a normal de-stocking over time?

Alan Clarke: I am a little bit wary of the official data because, if you look at the latest vintage of GDP, we had a monumental increase in stocks. It represents a contribution to overall GDP growth of 0.9%, more than the headline growth rate. This is a rerun of six months ago, not quite as big but something of the order of £3 billion to £3.5 billion stock-building. One month later the data were revised to show that stock-building showed hardly any increase. If you take the sum of inventories over the last year or year and a half, I would not be surprised to see inventories revised away into future releases and business investment was not as negative as suggested. That is not saying that business investment is growing. It is just that it is less negative than perhaps the official data suggests.

Mr Newmark: Does anybody have a different line than that to take, Melanie or Brian, before I go on to my next question?

Melanie Baker: No, I would agree with that. If you look at business confidence, it suggests that business investment should be higher.

Q122 Mr Newmark: What would you regard as the major risks to business investment growth over the next five years?

Brian Hilliard: An external one, of course, would be the Eurozone crisis. I think it is an extremely important factor improving confidence domestically, the Draghi approach to the Eurozone crisis. We have big challenges ahead in the next year or so, which are going to bring forward a sort of European banking supervisor. There are potential hurdles there that have to be negotiated. Domestically, I think imbalance from the housing market. I do share Alan's view, though, that splitting responsibilities to use macro-prudential tools from the housing market has a greater chance of success than previous policy cycles, but the downside risks: imbalance domestically and then a Eurozone crisis again.

Mr Newmark: Melanie, any thoughts?

Melanie Baker: External factors again would be the obvious ones because that does seem to be—

Mr Newmark: External factors are external. Let us just focus on what we control here.

Melanie Baker: It would be a sudden return to much tighter credit conditions. I think having a credit backstop is important, especially for smaller and medium-sized companies, to give them the confidence to invest.

Q123 Mr Newmark: Let us just say we suddenly have a scenario in which tax rises. We suddenly get an increase in corporate taxation perhaps or borrowing is increased because someone wants to accelerate growth a little bit more or they want to spend more on the public sector, the structural deficit doesn't decline any more. How would that impair things going forward, if at all?

Brian Hilliard: Anything that gives you a heightened uncertainty about policy is going to hurt business investment. I smiled because I blanch at the thought of a Government seriously considering raising the corporation tax, having seen—

Mr Newmark: We have had the Shadow Chancellor say that he would increase taxes on big companies, hasn't he?

Brian Hilliard: Yes, but saying it is one thing and to do it is another.

Mr Newmark: He said it and his strategy is to borrow more and to not deal with the structural deficit. We looked forward five years.

Brian Hilliard: Yes, but you can attack that in a variety of ways. That does not necessarily mean to say that you are going to reverse the fall in corporation tax, which I think has done a lot to improve British competitiveness. I doubt that it would be carried out.

Mr Newmark: Okay. That is interesting.

Q124 John Mann: If I have understood what you have just said, the biggest single uncertainty that business faces potentially over the next five years would be a referendum on the euro, would it not?

Brian Hilliard: It could do a lot of damage, yes, indeed. Let me express a personal view rather than a company view. Yes, I am amazed at the potential damage that could do. I think it has the ability to hurt foreign direct investment a lot.

John Mann: One could go into all sorts of arguments, but aside from the outcome, the fact that there would be a three-year lead-in if Parliament agrees the proposed legislation that has been put to us; a three-year lead-in creates three years' uncertainty for business of what the outcome would be.

Brian Hilliard: Yes, I am not disagreeing with you. I think it is potentially damaging to FTI.

Q125 John Mann: I am a bit bemused at all the discussions over the last few weeks. Business investment has fallen in the last quarter, 2.3% higher than for a considerable period of time, but you are all telling us, as I understand it, you anticipate that what should be happening is business investment should be growing and yet on the last quarter, not just has it not grown but it has fallen. What has gone on here with businesses? Mr Clarke, you were—

Alan Clarke: From my recollection, we picked up quarter on quarter in the third quarter GDP, partly reversing the drop in the second quarter, so year on year, we are down 6.3%. Why have they been reducing investment? I guess the uncertainty of the last year, when plausibly someone could have left the Eurozone; for the last couple of years, uncertainty on our own domestic recovery. As I say, six to nine months ago, you could have argued zero growth this year and why on earth would you have invested if you did not think there was an end customer for your product? It is a bit of a lagging indication in that regard, of once companies have built up confidence that the recovery becomes enduring, then I think they will be prepared to dip their toe in the water and invest and make good on depreciation, which naturally does give you some degree of investment growth.

Q126 John Mann: Melanie Baker, I understood that you said that you thought that a rise in wages would be helpful. There is a public sector pay freeze and there is not the business investment coming in to increase productivity, so where is the rise in wages going to come from?

Melanie Baker: We do expect a rise in productivity. We do expect business investment to pick up. I am saying there was a bit of a pick-up last quarter, so these things should start working better, and with stronger productivity, that gives a justification for higher wage growth. You may also see pay growth for other reasons as well. The RPI rate of inflation is still relatively high. Wage demands may pick up because fears of unemployment have fallen and there are skill shortages in certain sectors as well, but average earnings growth we are expecting to pick up, but we do need to see that for a more sustainable recovery.

Alan Clarke: Can I chip in on that, because obviously I have come across as optimistic on the consumer. I am slightly nervous about wages. I agree the trend is favourable and it is upwards. However, what has come out in the recent labour reports is that the claimant count unemployment is going down fast, about 120,000 per quarter. There is a corresponding increase in employment, 155,000 to 200,000. Those two offset one another, but the wider definition of unemployment is going down much more slowly, even though it includes claimant count, and that is because in activity, new supply is coming into the labour pool. At the moment, that is a drop in long-term sick and discouraged workers. Further down the road, we will have Bulgarian and Romanian workers coming in, so there is obviously an increase in demand for workers, employment is going up fast, but there is a corresponding increase in supply as well and that should slow the upward trajectory in wage inflation. I agree it should be up, but it could be perhaps a little bit slower than the OBR forecast.

Q127 John Mann: When I go around my businesses, I do not get this optimistic feel at all and I find it more pessimistic than it was even a year ago, with one exception, which is car dealerships. What the car dealerships are saying to me is that people who were buying second-hand cars have this year bought new cars. How certain can we be that is not a one-off, as in the trend of people buying new cars and changing them every year, which was there, as in people saying, "I will invest now because it is cost-effective and I will borrow to do so, but that is going to last me for three, four, perhaps even five years"? Any data on that?

Alan Clarke: It is a good chance there is. It is more an anecdotal report that suggests that people have spent the windfall from the PPI pay-outs for the last couple of years, which are due to come to an end pretty soon, on cars and holidays, so there is every chance it is out there.

Q128 John Mann: That would then suggest that the sudden growth spurt we have with the second-biggest factor after houses, for example, cars, could be temporary?

Alan Clarke: It is a further unwelcome headwind, but as a proportion of household disposable income, I worked the pay-outs out to be a drag of 0.25 to 0.5 of a percentage point on household disposal income, so wage inflation picking up from 1 to 2 would more than offset that, but it is cross your fingers and hope that wages pick up, because employment is going up.

Q129 John Mann: With all of that, I was a bit taken aback at how bullish the Governor of the Bank of England was, stating that we were leading the G7 in our growth rates, or increasing growth rates. I was with a German bank's economist yesterday, and their projection on growth is very significantly higher than the OBR's projections. The US growth

figures have just come out that are higher than ours. What is your view on where we stand in relation to our G7 competitors in how you perceive growth over the next couple of years?

Melanie Baker: Looking at our house forecasts, we are set to outperform much of the rest of Europe, for example, so within Europe there is a sense that the economy here is doing better.

Q130 John Mann: But to be precise, if we compare with the US, Canada, German and the Eurozone, how do you think we are going to do?

Melanie Baker: My confidence is greater in terms of an outperformance on the European front than wider.

Q131 John Mann: So you do not think we will outperform the others?

Brian Hilliard: Very little chance of that. The Eurozone economy is emerging from a deep crisis and still has considerable constraints on growth: credit, restructuring of the banking system. I do not think it is at all contentious to argue that the UK growth numbers are going to be far in excess of the Eurozone. We would expect the US to lead the way though. I think the pattern of growth in the US is more balanced and more durable in the UK and higher in absolute value in the next few years.

Q132 John Mann: And Germany?

Brian Hilliard: Germany probably no. Lower than us.

Chair: I am going to move on.

John Mann: That certainly contradicts what all the German economists are suggesting.

Chair: But not the IMF. I began by asking you about the long-run growth rates and I am going to pass the questioning to Andrea Leadsom now, but while it is with her, I would like those of you who are not answering the questions to also be thinking about what supply-side measures you think should be implemented to raise the long-run growth rate and I hope that you each will be able to come up with at least two before the end of the session. Andrea Leadsom.

Q133 Andrea Leadsom: Do not listen to me, just think of his question. I would like to ask you about austerity. We have had a huge amount of talk about austerity in the UK. Is it real? Has there been austerity economically in the UK, Miss Baker?

Melanie Baker: Yes. Our analysis is that there has been, so while you might not be able to see it so much in the real Government consumption numbers because of the way it is measured, you can see it clearly in departmental budgets, in the loss of public sector jobs. It is real.

Andrea Leadsom: Mr Clarke?

Alan Clarke: Mechanically, absolutely. Clearly there is a risk of a fudge factor in the structural deficit numbers. It depends what you think the output gap is, but whether it is 0.5% or 1% GDP per year, as the previous budget suggested, there has been mechanical tightening, which has been a headwind to growth.

Q134 Andrea Leadsom: But tightening is different from austerity, isn't it? What I am getting at is, has austerity been austere enough? In other words, had we cut more quickly, more deeply, would we have seen a faster return to growth? Are we seeing a slower recovery than we should do because of a failure to cut deeply enough, Mr Clarke?

Alan Clarke: Traditionally during periods of fiscal tightening, the pace of tightening has been about 1% of GDP per year, so that is roughly where the initial budget projections

were. Should we have gone faster than that? Other countries have: Greece, in the periphery of the Eurozone. There have been massive increases in unemployment, in excess of what we had. This has to come down to personal view, but I think that was undesirable, to have a worse labour market outcome here. I would rather have played the long game than the short game than had that sort of misery.

Andrea Leadsom: Mr Hilliard, what is your view?

Brian Hilliard: I would not like to have seen any tighter austerity. I think it was genuine, it was deep. It cannot be precise, but it is certainly real.

Q135 Andrea Leadsom: Miss Baker, is austerity working? Would you say that it is the cuts that are causing the economy to turn around or is it low interest rates or what is your assessment?

Melanie Baker: In terms of what is causing the economy to turn around, one of the supports has been that fiscal austerity is dragging a bit less this year, but clearly a big support is what has happened in the euro area, just the lower tail risks in the euro area and the confidence that has brought.

Andrea Leadsom: Mr Clarke?

Alan Clarke: I have nothing to add in excess of what has already been said, to be honest.

Andrea Leadsom: Mr Hilliard?

Brian Hilliard: Could you repeat the question, sorry? I was looking at something.

Q136 Andrea Leadsom: Yes. Going back to the beginning, there has been so much talk of austerity and how badly it has hurt our economy. What I am trying to get at is has austerity been at about the right level? Has it worked? Is it working? Is austerity enabling our economy to recover in terms of confidence and keeping our investment outlook and so on, and therefore is it making a contribution to the recovery or is it other factors?

Brian Hilliard: I think it was one vital contribution. I think it was necessary to demonstrate to the financial markets that we were taking measures to change the structure of the economy at a time when there were massive market attacks against governments that did not do that. It is certainly not the only plank of policy that has helped to generate a recovery. QE was a vital component of that, a complement to austerity, and it has helped to stabilise the economy, it has helped to bring in spreads in financial markets and deliver a boost to money growth. I would distinguish between the various phases of QE, but certainly if you are trying to suggest it was austerity alone that allowed us to be in this pleasant position we are in now, I would disagree.

Q137 Andrea Leadsom: Is austerity working—

Brian Hilliard: Yes.

Andrea Leadsom: —and what would be your advice to the Government by way of further cuts in order to improve our net indebted position and so on?

Brian Hilliard: Remove the ring fence would be my advice. If one looks at the share of public sector employment accounted for by national health and education in total, it is over 50%. I know not all of that is ring-fenced, but it would seem to me somewhat dangerous to continue on a path of deep consolidation in the public sector with that official constraint in place. That seems to me very dangerous and unbalanced.

Andrea Leadsom: Mr Clarke?

Alan Clarke: I would agree with that. I would agree with the line at the end of the IFS statement, which is there is not much more to squeeze out of austerity at the moment. There are several more percentage points of GDP tightening in the pipeline. I would not want to go

beyond what there already is, but yes, getting rid of the ring-fence is one unsourced tap of potential.

Q138 Andrea Leadsom: Miss Baker then, just a final question: would you say that carrying on as we are now, with the reported disappointment in the media that our indebted position and our structural deficit will not be paid off until much further down the line than originally forecast, is that a price worth paying for less pain felt in the economy? Do you think that we are on the right path or do you think that there are changes that are required?

Melanie Baker: I would certainly not suggest we should be ramping up austerity at this stage. I think we are on the right path in terms of fiscal policy.

Andrea Leadsom: All right, thanks.

Q139 John Thurso: Can I ask you one quick question about the productivity puzzle? Do you think there is any link between the subsidy for labour costs through in-work benefits and the productivity puzzle? Start there and just pop along.

Brian Hilliard: I think anything that has provided a subsidy to companies to help them weather the recession has probably hurt productivity in the short term. Was it a price worth paying? Probably. The issue is whether we should expect the survival of companies to change as the economy generates a stronger recovery. If it does so, are the zombie companies going to go to the wall? If that happens, then we are going to see a boost of productivity, but any general benefit that has helped companies survive I think has had the effect of reducing productivity almost mechanically.

Alan Clarke: I agree with that on the zombie company argument, but a growing company has a choice between expanding through increasing their capital investment or hiring labour and anything that has kept labour costs lower would channel you towards hiring, rather than expensive, long-term borrowing for investment. Something that has kept people hiring higher has contributed to slower productivity and it just comes down to a choice of desirability, whether it is better to have more heads in employment or slower productivity. Ultimately, it is better to have faster productivity, but in a deep recession where you want to keep the unemployment rate low, there is clearly an argument for that.

Q140 John Thurso: A final quick question. When the Governor of the Bank of England came before us, he broadly made the statement he was used to better statistical data in Canada than when he arrived here. Yesterday I asked the OBR whether they felt the ONS needed to up its game. How do you all feel about that, the quality of data?

Brian Hilliard: I am not in a position to compare in detail the UK against Canada, but generally speaking, one has a perception that they struggled when they moved to Newport, so that might be part of the issues they face. We have also recently had a questionnaire saying if they were to cut back on various areas of statistics, which would we think would be the least painful. That seems a slightly worrying thing to do, but the quality of statistics I think, broadly speaking, is easy to criticise.

Q141 John Thurso: Presumably it would be a relatively significant threat to our ability to make sound economic judgments if the ONS was cutting back on the data required to make those judgments?

Brian Hilliard: Yes.

John Thurso: Do you broadly agree?

Alan Clarke: The ONS has a tough job, because we have taken a conscious decision in this country to release our data earlier. Our GDP comes out weeks, if not a month, earlier than other countries because it was seen as desirable to have some data rather than relying on

what have been spurious indications from surveys. The ONS has a tough job; I have enormous respect for them. I have been out in supermarkets collecting prices with them to see physically how they do it. It is a tough job and they are in the public sector pay freeze and not compensated as highly as other industries. I think they do a good job. It has been volatile. It has been incredibly volatile since the 2008 recession.

Melanie Baker: As an economist, you always want to see better data and more data.

John Thurso: Yes, that is what Mr Chote said, roughly speaking. Thank you very much.

Q142 Chair: Can we get better data at a reasonable cost or not?

Melanie Baker: That is not a judgment I can make.

Chair: Okay. Does anybody know enough to be able to answer that question?

Alan Clarke: I do not think it would hurt to have a cross-border investigation of our ONS, investigate what happens in the US, in Germany to just see if we can do better. It would not hurt.

Chair: Who should do that? All right, you are not sure. Come back and give us a thought on that.

Alan Clarke: Sure.

Q143 Chair: Now for my starter for two or finisher for two: two supply side measures. Mr Hilliard?

Brian Hilliard: I will give you one, but I think it is an enormous one, and that is education. All of us sitting here has probably benefited from a good education and have seen the results of that. I am not an expert on education policy, but I think it is absolutely vital for the medium-term health of the economy.

Alan Clarke: It probably blurs the supply-side definition, but I will say it anyway. Energy is crucial. For me, once you have cut the green taxes, you cannot cut them again, so what happens in a year, two years' time when there is scope for further double-digit energy price increases? It is disturbing when you get headlines that a project to build a new supply facility is scrapped because of loss of subsidies. Arguably, these companies should be ploughing their profits in investing in future supply, but it disturbs me that France has many times more days of gas storage than we have. I remember last winter the headlines that we were within hours of running out of gas. This is not a problem that is going to go away. I think we should have investment either through Government or forced through companies to have greater supply facilities, because higher energy bills have for years been a squeeze on household disposable income—40% price increases here compared with half that in Continental Europe—and it could happen again.

Chair: Melanie Baker?

Melanie Baker: In an ideal world cross-party agreement on things like infrastructure planning—

Chair: Can we get out of the ideal world? Could we just have a proposal?

Melanie Baker: No, but to get certainty, a cross-party approach or more of that in certain areas where long-term decision-making is important to economy would be very welcome.

Q144 Chair: Do you think we need more money in education, Mr Hilliard?

Brian Hilliard: I think any area of Government would benefit from more money.

Chair: No, I am asking you to reflect the supply-side measures that you think we need to reach.

Brian Hilliard: I am not an expert in education, I just know that it is important for medium-term growth.

Chair: Was that a yes or no to my question?

Brian Hilliard: More money? Yes.

Chair: I have asked you for three supply-side measures and you have all come up with spending increases, haven't you? Having just told us that you think that you agree with the austerity—

Brian Hilliard: No, you asked whether more money might help education. I am not saying that is the only way you could improve education.

Chair: Two out of three then. Thank you very much indeed for giving evidence this morning, extremely interesting.