NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH:
PRESS CONFERENCE
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Opening remarks by the Director

Good morning. Welcome to the *National Institute of Economic and Social Research* for the release of our Summer 2021 *Global Economic Outlook* and our *UK Economic Outlooks*. Our *Global Economic Outlook* focusses on the developments in the world economy projected by our global econometric model, NiGEM as well as providing scenarios to help us understand emerging macroeconomic issues. The *National Institute UK Economic Outlook* assesses the aggregate picture but increasingly places weight on its micro underpinnings at the sectoral, household and regional level. We are hugely encouraged to think that a large part of the COVID19 crisis is now behind us. But in its wake the crisis has left many questions about regional and national resilience, as well income inequality, that policymakers must address. The call for better forms of cooperation has more often been made than answered but with more than 4mn deaths and countless lives disrupted, a new approach and institutional capability must be found.

The Global Economic Outlook: Lifting the Pandemic Cloud

The Covid pandemic placed much of the world in a cloud of uncertainty. And while the viral shock has been common to all countries of the world, the economic and social consequences have exposed considerable differences in country-level initial conditions such as the quality of health and social care, the importance of social consumption and the coverage of fast broadband. But it has also exposed two aspects of the policy making process: the quality of political decision-making and the space for monetary and fiscal policy to provide temporary support for households and firms. The deployment of monetary and fiscal tools tells us not only about the advantages that advanced economies have but also about the more abrupt and damaging adjustments that many emerging and poorer economies are facing.

Most advanced countries have been able to exploit their policy space to support firms who have suffered temporary losses in revenue and households who have shed jobs and income. Prompt action by central banks in the spring of 2020 have prevented any obvious dislocations in financial markets and the banking system seems to be well placed after the global financial crisis as it is better capitalised and holds more liquidity than it did in the first decade of this century. But the main support has been offered by fiscal policies that have cranked up public debt in advanced economies by some 15-20 per cent of GDP. Nowhere exemplifies this more than in the US, where a fiscal injection of some 9 per cent of US GDP has accelerated growth so that the economy seems to have returned to its pre-crisis level of activity by the midpoint of this year. But at the same time, supply chain shortages and step changes in many commodity and producer prices have prompted increasing concern that goods will follow asset prices and suffer a sustained inflation.

And for both strands of policy one can detect a change in tone. The period after the great inflation of the 1970s and early 1980s, a formative period for me, set the tone for orthodox policies directed at price stability and for sound money. The building blocks of this approach were an inflation target and the pursuit of stable or falling levels of public debt to income. The moves to change the target of the Federal Reserve and to increase the explicit target of the ECB do not by themselves undermine price stability but have led many to ask if they do. Many have also argued for an increase in the inflation target, which I do not support.

On fiscal policy the tide has turned away from arbitrary targets such as those enshrined in the Maastricht criteria, and in a myriad of IMF lending programmes, to a more sensible view that fiscal policy is a tool to manage risks rather than an instrument that cowers in the face of realised risk. Our own work on fiscal frameworks is instructive. We need less by way of rules but more of active approach to fill obvious gaps in the provision of public goods. Here the advanced economies are at a distinct advantage as they can issue debt which is treated as risk free and hence capture some fraction of the pool of savings that might better have been devoted to poorer countries where the social rate of return is almost certainly higher. They can also, if they had the foresight, develop better aid and support programmes for poorer nations that will tend to foster trade and productivity on both sides of the exchange.

Clearly the benevolent dictator that does not run the world might stack up some of these developments differently. Advanced economies seem to have insulated themselves from economic shocks and have also then had first dibs on the vaccines. Are our institutions for ensuring equitable distribution of finite resources insufficiently strong to bring about a better allocation? It does sound that we in the advanced economies are having our cake and eating it, and then complaining about the resulting case of obesity. The IMF's new issue of SDR will support the liquidity position of poorer countries but so would agreeing to free vaccine supply from the constraints of intellectual property. Ultimately the real test of any new framework will be whether we can adopt new ways to co-operate over man-made climate change at this year's COP26. Whether it is the pandemic or global warming, the same maxim applies with the same implication for sustained international co-operation: *This Won't End for Anyone Until It Ends for Everyone.*

UK Economic Outlook: Emerging from the Shadow of Covid-19

It seems likely that later this year or early next the economy will return to the level of overall activity recorded at the end of 2019. But even if activity in aggregate returns to pre-crisis levels, with services and construction in the lead, neither manufacturing nor agriculture seem likely to do so. We also then expect to see considerable regional variation in the short- and medium-run, with the economic prospects of London showing most resilience and the Midlands and Northern Ireland looking particularly vulnerable. More importantly the economy has lost some two years of economic growth and sectors, such as hospitality and the arts, which are so important to UK plc may bear the scars for some time to come. And although there are encouraging signs in the rate of Covid infections, it is far too early to get out the bunting. Once again, a crisis has exposed exiting vulnerabilities and we need to focus on our policy responses.

There are four specific areas to watch carefully in the second half of this year. First, the calculus on lockdowns and exit remains complex. And we cannot rule out the need for further constraints on our social interactions. It has never been a mechanical question of lockdown versus liberty and correspondingly recession or growth but a question of how we decide on the deployment of social controls under great uncertainty of their impact. The more infectious Delta variant showed signs of rapid growth, and while the hospital mortality rate is considerably lower than we saw in 2020, for a time the numbers were worrying with the risks heavily skewed into a mad world of a rapid growth in infections. That said, nobody can be certain what will happen in the second half of this year and there are some preliminary indications that we may have achieved her immunity. So policy must be guided by the risks we can estimate as well as the uncertainty induced by changing policy. In general, a good principle is to respect the risks, as they sit on the side of the worst case, and bear in mind that we do not quite understand the result of a policy intervention – in this case – to open up. This means that we need to move in a gradual and cautious manner. But think more carefully about the protocols around those who may have been exposed to the virus and have been vaccinated and what support we provide to those who cannot work as a result of Covid-19.

Second, in the labour market, as the furlough scheme winds down, we need to understand what fraction of those employees will be taken back on by firms and how many will be made redundant. Related to this, what specific support might be offered to help those losing their jobs, or entering the labour market, to search for work or train for new careers? Our own analysis is that the fiscal burden of the furlough scheme has paid for itself in terms the direct costs of the scheme and the alternative of considerably more unemployment. Indeed, the University and further education sector seems well placed to offer re-training schemes and support employment rotation.

Thirdly, there has been a good rate of new company start-ups and, so far, firms have not suffered large scale bankruptcies and debt default. This tends to be a good indicator of future employment and may support future productivity, but the composition of these new firms has been strongest in those sectors that are best able to withstand social distancing. These may not necessarily be the best firms to promote enduring prosperity. Firm growth of low wage service sector is welcome but a preferable source of national productivity is the development of internationally competitive firms around the country supporting local demand. It is also of concern that the corporate sector is now carrying even more debt, which may act as drag on future hiring and investment.

Fourthly, as an economy sensitive to the fluctuations in world trade, the UK remains acutely to any failure to control the virus overseas.. This means that for as long as the crisis casts its shadow, the denuded prospects for tourism, international trade and labour mobility may act to constrain UK activity. So, as well as an ethical issue, self-interest also dictates that we ought to be in the lead of arguing for waivers on intellectual property so that the vaccine technology can be shared with the world.

We cannot think simply in terms of a fixed capacity for production in the economy for which policy simply acts to stoke demand. Government and Bank of England policies should be used to support the most efficient and dynamic production of goods and services. Attention must be paid to maintaining the credibility of our institutions to manage inflation risks and the stability of the financial system. But, as we face obstacles to the recovery from Covid-19, H M Treasury and the central bank must also show flexibility to support our continued fightback from the pandemic.

At present our hapless fiscal framework – the rules the government sets for managing the public finances – is under scrutiny by H M Treasury and we wait for its next iteration. But so far we have failed to adopt a transparent timetable for our fiscal events and more formal scrutiny of the normative choices made by H M Treasury. But what we do not need are yet more arbitrary rules; fiscal policy needs to be directed at the regional and household inequalities that the pandemic has both highlighted and exacerbated. It could well be that, although we have a ministry of finance, we need a ministry for the economy. This might support a more consistent and durable set of economic policies.

Last spring, monetary policy responded well to the initial lockdown with a cut in interest rates from the Bank of England and an increase in the size of the quantitative easing programme. With the recovery in train, it is now time to complete the task of forward guidance and explain better what might happen to Bank Rate and the stock of asset purchases as the economy bounces back. In sympathy with the recent report from the Lords Economic Affairs Committee, we argue for more clarity on how we will exit quantitative easing and move towards quantitative tightening. It is simply not enough to focus our attention on small changes in the base rate that may or may not matter. What matters is that financial capital is matched with the most productive prospects at the best global terms.

Not so long ago the only thing that seemed to matter was how and when we delivered Brexit, and what that might mean for an economy that had suffered a prolonged period of underinvestment. Now, as we think about how to plot a way out of the Covid crisis, it is precisely those gaps in human and physical capital that we need to fill in order to deliver sustainable and balanced growth across the country. It is the biggest problem we face. Can we solve it?

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2nd August 2021