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Is now the time to switch Britain's mix of economic policies?

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Roger Bootle is keen for Chancellor Philip Hammond to spend more money

Listening to Mark Carney last week, you could be forgiven for thinking that the UK economy is in danger. In reality, we know remarkably little about what is now happening.

The GDP data for the second quarter, when businesses and consumers should have been suffering from the greatest Brexit uncertainty, turned out to be surprisingly strong.

Surveys have recently suggested marked weakness, but since these were conducted post-referendum, they may well be picking up a knee-jerk effect, as well as a reaction to the apparent paralysis of government, which has since been swiftly ended by Mrs May's coronation. Admittedly, it is also possible that the economy is weakening. We simply don't know.

Theresa May's rapid appointment as Prime Minister is likely to calm markets and boost confidence CREDIT: EMMANUEL DUNAND/AFP

Bear in mind, though, that after the pound's ejection from the ERM in 1992, it was some time before Black Wednesday became referred to as Golden Wednesday. Although today's circumstances are different, I think there is a pretty good chance that something similar will happen. This is not to say that last week's package of measures from the Bank of England was wrong. On balance, I support it. But when it comes to the future, it is not clear that there should be more of the same.

First, the Bank should wait for information about the state of the economy. Thereafter, although it might make sense, in due course, to extend quantitative easing, the same does not necessarily apply to reductions in interest rates.

Whenever I write about my support for a policy of low interest rates to boost the economy, I am besieged by Disgusteds from Tunbridge Wells complaining about how unfair it is that they are made to suffer when they did nothing to contribute to the crisis.

Sadly, life is unfair. For the Bank of England, the more important question is whether yet further reductions in interest rates would work. Although the Bank won't quite say it, penalising saving is one way that the policy might work, by making people feel returns are so low that they might as well spend some of their money on goods and services, or some sort of asset.

However, cutting savers' income may persuade some that they need to cut their expenditure. Meanwhile, those saving for retirement – or companies providing pensions – may be persuaded by lower returns to save more. And if banks' profits are squeezed because they are unable to reduce deposit rates as much as lending rates, then this could impair their ability to lend.

After the financial crisis, the policy was to operate a fiscal squeeze, offset by ultra-easy monetary policy.

This mirrored what happened after the departure from the Gold Standard in 1931, and again following our ERM exit in the mid-1990s. The only major difference was that, under George Osborne, the pound trended higher. Now that the pound has fallen, we could operate a combination of policies that looks like a carbon copy of what has worked so well before.

Yet, as regards any further changes, the factors governing the appropriate mix of fiscal and monetary policy have changed. Admittedly, the pound remains a key consideration. If we need further monetary ease to keep the pound down at its new lower level then I would support it. But if we don't, then for the reasons given above, I doubt that further monetary stimulus will do much good.

Meanwhile, the arguments in favour of looser fiscal policy are becoming stronger. When Mr Osborne became chancellor, monetary policy had not quite reached the end of the road and the government debt ratio was rising alarmingly. Now, monetary policy is close to the end of the road while the debt ratio, although still rising, is coming close to a peak.

Moreover, having gone through the austerity package, it is now easier to relax policy while still retaining fiscal credibility. With that credibility intact, ultra-low interest rates help because they support ultra-low gilt yields, which minimise the cost of servicing the Government's debt.

Fortunately, by the time of the Autumn Statement, the Chancellor will have much more information on which to decide whether to enact a fiscal loosening. Usually, we economists tend to think looser fiscal policy goes hand in hand with tighter monetary policy. But measured against where we are, some sort of fiscal easing would surely not be accompanied by monetary tightening.

I am sorry for all my friends in Tunbridge Wells, but the regime that imposes paltry rewards for saving is likely to persist for some time yet.

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