

U.K. Can't Inflate Debt Away, New Head of Fiscal Watchdog Says

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By Alex Morales

(Bloomberg) -- The U.K. can't inflate away its burgeoning debt pile in the way it has done in the past, the man chosen by the Treasury to head up its fiscal watchdog said.

About a third of U.K. debt is index-linked, so higher inflation would push up the cost of servicing it, Richard Hughes told the House of Commons Treasury Committee on Monday.

"We have lost one tool than we had in the past to actually reduce our debt stock so we have reason to be more alert to the risk of higher inflation than a lot of other countries do,"

Hughes said. He described as "idle chat" the notion Britain could "pull the same trigger that governments have in the 1950s and 60s of using inflation to actually erode the real value of our debt."

Chancellor of the Exchequer Rishi Sunak has racked up record levels of debt as he tries to support businesses and workers through the coronavirus pandemic and economic lockdown.

The U.K. is on course to borrow an unprecedented 350 billion pounds (\$441 billion) this fiscal year, and the outbreak has already pushed the national debt above 100% of economic output.

At 17 % of economic output, this year's budget deficit would be the highest since World War II.

The chancellor and Prime Minister Boris Johnson have repeatedly said they're not planning on pursuing austerity policies to rein in government spending, and for now Sunak has

focused on preserving jobs to avoid long-term scarring of the economy. He unveiled a 30-billion pound stimulus program last week, and plans a wider package in a budget in the fall.

Sunak Tries to Save the Summer with \$38 Billion Stimulus

Hughes said while there are upside and downside risks to inflation, they're tilted toward it remaining below the Bank of England's 2% target. He also warned that the debts being built up by companies to tide them over the pandemic could end up becoming a burden that leads to scarring of the economy.

"One of the concerns that we've had is that the longer the crisis goes on for, the more likely government-guaranteed loans becomes less of a facilitator of the recovery and more of a burden," he said. "The more the debt is a burden on companies the less they will invest. We know from past crises that one of the reasons you see longer-term scarring on the economy is you have foregone investment, and that scarring can be significant."

He suggested one way to mitigate for that effect would be to tie repayments of the government-backed loans to a company's earnings and profitability.

Hughes said high frequency data pointed to a "a bit of good news," with April representing the low point for the economy and output contracting by about 25% instead of the 35% initially forecast by the OBR. The question is how quickly the economy gets back that loss.

Current OBR projections are based on Britain and the European Union striking a free-trade agreement. If talks fail and Britain is forced onto WTO rules when the current transition period ends in December, there will be adverse "consequences" for growth and the public finances, he said.

Sunak named Hughes last month as his preferred candidate to succeed Robert Chote as chairman of the Office for Budget Responsibility in October. Hughes's appointment depends on the Treasury Committee's approval following Monday's pre-appointment hearing.

To contact the reporter on this story:

Alex Morales in London at amorales2@bloomberg.net

To contact the editors responsible for this story:

Tim Ross at tross54@bloomberg.net

Andrew Atkinson

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