

What are the main risks to the economy?

Question 1: What are the three main risks to economic stability in 2007? How concerned should people be?

Risks

US slowdown	27
Market turmoil as risk aversion rises	21
Global imbalances/dollar crash	20
Geopolitical / oil	17
Higher inflation	15
Protectionism	6
UK house prices	6
Higher UK rates	4
Higher saving rate	2
Unemployment and debt	2
China diversifies dollars	1
Tax revenue shortfall	1
UK fiscal	1
Congestion	1
Sterling crisis	1
Asian slowdown	1

Far from espousing the gloomy predictions often heard from practitioners of the dismal science, economists view the prospects for the economy in 2007 more positively than in either of the previous two years.

The main risks they see come from abroad. If there are to be problems in the economy this year, they will arise from a US slowdown, turmoil related to sharp swings in the US dollar's value or geopolitical crises, the 49 economists who answered the Financial Times annual survey thought.

But optimism, shared by financial markets in the second half of the year, was the dominant mood, from economists of all ilks.

Marian Bell, the former member of the Bank of England's monetary policy committee, listed geopolitical events, a sharp US slowdown and higher UK inflation as her three main risks but insisted: "These are risks not most likely outcomes".

Robert Barrie of Credit Suisse agreed: "The trend has been for the global and the local economy to experience more upside than downside risks in recent years and next year could see more of the same".

Sir Alan Budd, the former chief economic adviser to the Treasury and MPC member, calculated odds of an 85 per cent chance no risks would materialize and said that even if something did go wrong with the global economy, "in recent years the economic and financial systems has coped well with shocks so ... the consequences may not be serious".

But after the knock-on effects of any US slowdown, it is precisely the high valuations of markets around the world, which are priced to suggest risks are low that concerns two in five of the economists polled.

Professor Willem Buiter, the former MPC member, said his main concern was a global "re-normalisation of credit risk premia across the board".

"They have fallen to ridiculous lows and are begging for a correction. This could become a double whammy if low long-term risk-free real interest rates were to return to normal levels at the same time," he added.

Gerard Lyons of Standard Chartered Bank said that he thought "the world economy shares many characteristics to Japan before its crash: strong growth, relatively low inflation, rising asset prices and low risk premia".

While any of these could become troublesome for the global economy, James Knightly of ING spelt out the problem the global risks are "potentially intertwined, so the risk of significant global economic instability should not be downplayed".

With global concerns uppermost in the minds of economists, risks closer to home played little role. Only higher inflation, linked to wages rising faster than expected was mentioned by more than six economists.

While concern about inflation was hardly mentioned in the past two years, it is understandable as higher than expected inflation represents one of the main surprises this year. But the other age-old concerns of British economists, the housing market and the public finances are causing few of them to lose any sleep. Only six were concerned that the housing market could disrupt the economy in 2007, while only two mentioned weak public finances as a cause for concern in 2007.

Other comments:

Ian Plenderelith, former MPC member

Excessively fast adjustment to global imbalances: Adjustment is taking place, but steady and gradual is what's needed to avoid undermining growth. Further sharp falls in dollar and/or serious slowing in China would be very unhelpful - and emerging markets would suffer particularly in the side wash.
Greater protectionism.

Excessive reaction to threat of terrorism. It is a real threat, but each new layer of security adds to costs and the need is to strike a balance - not easy, I agree.

Richard Jeffrey of Ingenious Media

The biggest and potentially most disruptive threat to economic stability must remain terrorist activity - which probably speaks for itself.

Following this, in the near term, the US could have a disruptive influence if its slowdown proves more protracted and severe than most currently anticipate. In fact, my belief is that the US economy will gain momentum in the second half of next year. However, were this not to be the case, there would be knock-on consequences for other economic areas. The impact on the UK could be more severe than on other economies in Europe, since I anticipate that domestic demand will also be decelerating here.

In a more parochial context, higher than anticipated core inflation in the UK economy could provoke a more aggressive response from the MPC than seen to date. Because the leads between policy action and economic impact are so long (and because policy makers become impatient), there is a risk that interest rates could be raised higher than necessary to contain inflationary pressure, as has happened in previous cycles. This risk is probably less under current monetary arrangements, but it cannot be entirely discounted.

Ross Walker of Royal Bank of Scotland

The downturn in the US housing market presents the most immediate risk to global economic stability. On balance, the abrupt nature of the slowdown in 2006 provides more grounds for reassurance than concern. Thus far, contagion has not obviously spread to US consumer demand in general – employment growth remains steady and the pick-up in income growth should underpin demand - and the rapid correction in the construction sector suggests these risks may dissipate more quickly.

Bridget Rosewell (Chairman of Volterra Consulting)

a) US slowdown takes hold - a big concern but always remember that the US economy can bounce back quickly too

b) China decides to strut its stuff and sells dollars aggressively. This would destabilise international financial arrangements and would be a severe crisis. Maybe quite a low probability but a big impact

c) On the domestic side, tax revenues are hard to raise as people try harder to avoid liabilities. General disquiet at ineffective use of funds disrupts spending plans and creates uncertainty - medium level concern

Finally there is the risk we haven't thought of. The outlook appears very benign, but it is hard to believe its really so easy! Maybe this is just forecasters pessimism

Philip Shaw – economist at Investec Securities

- i) A sudden rise in risk aversion or 'global liquidity' drying up (different sides of the same coin). In either case there is a risk of widespread declines in financial asset prices ranging from emerging market paper through to G7 corporate bonds and stocks. The events in May were an example of what could happen on a more violent scale, potentially destabilising the global economy. If the credit cycle turns sharply, refinancing leveraged transactions could be difficult or at best expensive, and there could be a real test of whether the derivatives market (credit default swaps etc.) help to insulate risks, or inflame them.
- ii) Rising protectionism hitting trade and capital mobility - Democrats in charge of Congress and sounding fractious on China, Doha round not settled, Thai currency restrictions all suggest that this could be a risk.
- iii) Sharp fall in the dollar putting downward pressure on US asset markets. A bit of a hardy perennial this one, but it's still on the radar screen.

Michael Hughes of Baring Asset Management

- escalation of Middle East conflict involving Iran and Israel with resultant impact on oil price;
- credit supply contracts increasing credit default risks;
- protectionist policies begin to appear;

Howard Archer of Global Insight

A sharp dollar fall
A hard landing in the US and housing market crash
House prices in the UK overshooting substantially

All of these are very realistic risks that could ultimately have damaging repercussions for the UK economy, either directly or indirectly.

Ray Barrell of National Institute of Economic and Social Research

Risks look 'normal' over the coming year, which means there is a balance of positive and negative. Upside for growth and inflation is the risk of lower oil prices. A further risk premium induced fall in the dollar reduces both growth and inflation in the short run so it is one downside and one upside. Global excess liquidity remains a problem, and it could produce a rise in inflation on a global scale if expectations change, or a drop in growth if the financial sector becomes unstable.

Ben Broadbent of Goldman Sachs

For the UK, US growth would be the main risk factor. Otherwise, tighter monetary conditions will (We expect) reduce demand growth, but not to the degree one could call it "instability". Housing market.....you know my views!

Keith Wade of Schroeders

- a hard landing in the US as the downturn in the housing market snowballs into something more significant via its impact on US consumers,
- a sharp and disorderly decline in the dollar.
- Inflation proves to be sticky and does not moderate in response to sub trend growth.

The greatest risk is the first, but it is not a major worry as the Fed can respond. The other two would be more damaging but are less likely.

John Calverley of American Express

- a) Markets are pricing in another good year without major risk upsets. While this optimism is, in my view, largely justified, if something unexpected goes wrong we could see substantial volatility and some big market declines. This could be enough to hurt the economy.
- b) High housing market valuations continue to worry me. I stick with my view that recessions cause housing crashes rather than vice-versa but if we did see a minor recession in the UK, US or some other places, falling house prices could turn it into a bad one.
- c) There are several low probability high-impact scenarios, including human-to-human bird flu, mid-East war etc. Fortunately they are low probability and probably the only defence for investors is high grade bonds.

Peter Warburton of Economic Perspectives

Not sure whether this question is posed in a global or a UK context. While there are economic stability issues unique to the UK, the most serious ones emanate from global contexts:

- A Credit derivatives of sub-prime US mortgages and associated structured products
- B Collapse of hedge fund strategies relating to structured products
- C Global credit crunch accompanying US economic deceleration

Clearly, very concerned, since I consider that US bond yields are suppressed due to immense moral hazard problems.

Ian McCafferty of the CBI employers' organisation

- i) A disorderly devaluation of the dollar would provoke serious re-evaluation of risk and volatility in financial markets
- ii) Major terrorist activity
- iii) The disappearance of the "Greenspan put" - that the worsening of the global growth/inflation trade-off prevents central banks from loosening monetary policy in response to either financial market volatility or weakening global growth

These are real concerns, though in no particular order. Economic conditions in the US are more conducive to a weakening dollar than for some years, and this could yet turn into a disorderly decline, if investors willingness to continue to overweight the US comes into question. We are also seeing the beginning of the end of the decade of "easy money" (low real interest rates since the Asian crisis of 1997) which has provided the liquidity conditions for buoyant asset markets and rapid global growth alike.

Paul Guest of Economy.com

The biggest domestic risk is the household debt burden and relatively low savings rate. The adjustment to this could have a sharply depressive impact on private consumption growth and therefore on economic growth overall. I'd say the next biggest risks are international, in the form of a deeper-than-expected downturn in the U.S. and also with regards to the unwinding of the lingering imbalances in trade and foreign exchange valuation.

Howard Davies former MPC member and director of the London School of Economics

The main worry has to be the threat of protectionist legislation in the us. Paulson's trip to china seems not to have delivered what he hoped in terms of exchange rate flexibility. There is therefore a risk that tariffs are once again proposed in congress, whose impact, perhaps initially psychological, could be serious.

My second concern is that a sharp correction in the us, and UK housing markets, could slow consumer spending significantly, with damaging effects on confidence.

A third, but lesser concern is that a highly leveraged private equity deal goes wrong. Some of the financing structures look racy to me.

Fionnula Earley of Nationwide Building Society

* Wage inflation becoming embedded

* Unemployment continuing to rise which could cause problems with debt repayments etc

* The energy market may still be vulnerable to geo-political tensions and OPEC production levels so we could see prices rise again.

Professor Mike Wickens of the University of York

The US dollar:

The biggest risk is the US dollar and its effect of UK and EU competitiveness in the short run. This may cause quite a lot of uncertainty. In the longer run the US economy should be stronger as a result of a weaker dollar. This should generate higher US economic activity and give a boost to exporters.

UK fiscal position

I do not like the increasing size of the UK public sector's share in GDP through government attempts to expand expenditures too much and too fast, not the deceptive methods of finance. As these are permanent expenditures they should be tax not bond financed. But we are seeing increasing debt and tax rises hidden behind green issues. Since 2000 there has been a succession of over-optimistic tax revenue forecasts due to an over-optimistic view of GDP growth.

Congestion

The economic costs of congestion are rising steadily and a long-run solution is needed. Unfortunately, the problem with pricing people off motorways is that it undoes the original motivation for them as it encourages the use of minor roads which go through towns and villages which motorways were introduced to avoid.

Stephen King of HSBC

a. Knock-on effects of the US housing market on both the US economy and the rest of the world.

b. A dollar decline that exports the US downswing to Europe.

c. A recognition by financial markets that policy makers are right to be worried about the degree to which globalisation complicates monetary policy decisions. A significant rise in risk premia is associated with this reality check.

David B. Smith, University of Derby

Geo-politics remain the major concern, especially the prospect of a nuclear arms race in the Middle-East.

Main Economic risks are:

- First, if China and other Asian economies decide to let their currencies float (or appreciate to nearer their fundamental value), they would cease building up their FOREX reserves, which are mainly invested in government bonds. This would eliminate overnight the false market in bonds in the west created by Asian official purchases, and real bond yields would jump towards a more normal level. This would then have a serious impact on the price of all assets such as equities and property, whose value represents the discounted net present value of future returns/housing services etc. Higher real bond yields should also, in theory, lead to slower monetary growth, whipping away much of the 'excess liquidity' support for present market levels.

- Second, in terms of relative output-corrected broad money supply growth, real interest differentials, relative tax burdens, PPPs, and the credibility of fiscal policy, sterling now looks like an accident waiting to happen. As of now, the FOREX markets are sensing policy inconsistency between a weak fiscal background and a strong monetary authority, a combination that promises high interest rates by international standards, and a strong currency in the short-term, but not in the long-run if the markets decided that there are limits to how far the MPC is prepared to raise interest rates. If sterling does come under sudden downward pressure it might well result from unforeseen events overseas, for example, the end of the carry trade (see above).

-Third, the general loss of credibility of the UK political class could be extended to the MPC, which could be perceived as tarred with the same brush. The high 'headline' inflation figures, and the tax squeeze on real personal incomes, could further undermine the credibility of the official inflation target, and lead to a rise in inflationary expectations. The result could be the development of a stagflationary bias in the UK economy, that might require an interest-rate overkill to eliminate.

Professor Patrick Minford of Cardiff Business School

Over-tight monetary policy in the US, EU and UK. None of these central banks has yet understood the effects of its own monetary framework; this keeps inflation down via the expectations mechanism. Hence the key need is to keep clear and transparent the commitment to the inflation target, and also to stress its complete symmetry so that deflation is also countered. Such things as 'add-on money targets', chat about 'bubbles', and even discussion of fiscal policy is at best otiose, potentially confusing, and at worst downright inconsistent.

Diana Choyleva of Lombard Street Research

Sino-US hard landing; global liquidity squeeze; the explosion of derivatives

Wynne Godley of Cambridge University

In relation to your questions there is only one important point where I have a distinctive opinion. I think the public discussion regarding the US (so far as I can follow it) exaggerates the importance of the wealth effect of falling house prices on private saving and spending relative to the effect of the fall in lending to the non-financial private sector. I realise that the two effects are related to one another, but a fall in lending (i.e. a fall in the growth of debt) can, and I believe will, continue even if house prices do not continue to fall. In sum, I think that the forces making for weakness in domestic demand in the US are likely to be larger and more persistent than most people are now supposing.

I doubt whether there can be a rise in net export demand large enough to neatly offset the weakness in domestic demand (in the US) in 2007 but this might start to happen, particularly if the dollar goes on falling.

I think the US current account will improve a bit - but as much because domestic demand is

weak as because of the \$ depreciation.

Graeme Leach of the Institute of Directors

Three main risks are:

- (1) Geo-political - Iranian situation deteriorates and oil prices spike. The previous oil price spike was at a different stage in the economic cycle to now. To use a boxing analogy, the world economy took the punch early on before, but the same punch in 2007, in the 10th round, could do a lot more damage.
- (2) Housing market related and US slowdown from negative housing wealth effects on consumption and US GDP growth.
- (3) UK housing market related - UK house prices fall in the second half of 2007, due to the scale of current overvaluation and HP to income ratio at 6+. This 'pop' scenario contrasts with our central 'hiss' scenario whereby price growth slows sharply in the second half of 2007. This creates a more pronounced cycle, with stronger GDP growth in half 1, but 5.5% plus interest rates slowing activity thereafter.

Katherine Booker of Oxford Economics

Middle East tensions leading to renewed oil price spike; higher UK interest rates; US recession leading to wider world downturn. It would probably take all these scenarios occurring at once for the economy to fall into recession. The economy has already dealt remarkably well with one fairly severe oil price shock, but the mitigating factors that helped - immigration keeping wages down and cheap imports from emerging economies - might not be so supportive this time around. With a highly leveraged household sector, one could envisage a consumer led recession if interest rates were to pass 6%, but the probability would be low - less than 20%.

David Owen of Dresdner Kleinwort

- a. A collapse in the dollar (although I would say that, wouldn't !!)
- b. Geo-political risk
- c. From a UK perspective, a sharp correction in the housing market

George Buckley of Deutsche Bank

Our view is that global growth will follow an 'M' cycle like it has over the past few decades. But there are clear risks that the mid-M slowing is more acute. Central banks will respond by easing policy, including the BoE eventually, but a sharper slowdown is a risk. Globally, the biggest risks we identify are a further collapse in the US housing market (and any associated spill over effects) and an unruly decline in the dollar.

Paul Mortimer-Lee of BNP Paribas

Financial stress in global economy (encompasses disorderly correction of USD, sharp rise in risk aversion affecting stock markets, spreads and banks' attitude to lending). 30% chance.

Worse inflation than envisaged (maybe through oil market disruption) which would force central banks to be more restrictive and cause a recession. 25% chance

Neil Blake of Experian

US recession; over zealous UK monetary policy; household debt & default crisis

Jonathan Said of the Centre for Economics and business research

A cooling of world asset prices, the slowdown in US growth, a slowdown in Asian growth. Slightly concerned: we expect these factors to occur, but the impact on growth in Europe will not be strong.

Malcolm Barr of JP Morgan

In order of importance

1. US-led global slowing possibly exaggerated by a sharp fall in the dollar
2. Shifting inflation dynamic forces outright tight monetary policy
3. Household sector financial adjustment accelerates, driven by 2.

To large extent these risks have been with us in some shape or form for some time, but both the UK and global economy have shown an ability to generate growth despite them. We should be concerned, but not more so than has been usual over the last 3-4 years.

Milan Khatri of the Royal Institution of Chartered Surveyors

Main worry : aggressive interest rate rises globally as deflation pressures continue to reduce, prompting a global reassessment of risk appetite, which will hurt non-main stream asset classes like property.

John Muellbauer of Oxford University

1. Middle East conflict and disruption to energy supplies; 2. US recession - very unlikely. 3. Stagflation which could knock asset prices, leaving highly indebted UK households in difficulties. I see this as more likely to be problematic in 2008 than 2007.

Martin Weale, director of the National Institute of Economic and Social Research

Sharp rises in saving in US (perhaps a consequence of weakening property prices or a further dollar fall).

Entrenched inflation in UK requiring interest rate rises to 6 per cent or more.

A correction to the house price bubble in UK starting.

Risks are always with us and there is no reason to believe that the economy is more accident prone or less accident prone than in the past. But many forecasters (not NIESR) always say that the current situation is particularly uncertain so I suppose they may be right.

David Frost of the British Chamber of Commerce

A sharp slowdown in growth, mainly in the US & the Eurozone.

Sharp currency volatility (e.g. dollar collapse or sterling overshoot), and the consequent heightened trade tensions, mainly between the US, Europe & China.

Geo-political threats, e.g. terrorism and regional crises, leading to worsening business uncertainties & renewed surges in oil & metal prices

Good businesses have an enormous capacity to adapt to new circumstances and create opportunities, recognising globalisation as a challenge to be met head on not a threat is vital

and being innovative and planning ahead are essential.

Charles Goodhart, former MPC member

- (a) Sharp decline in dollar
- (b) Mid-East Turmoil
- (c) Financial disturbances from defaults of over-indebted companies

Jonathan Loynes of Capital Economics

A major US economic slowdown, a disorderly decline in the US dollar, and a rise in protectionism. Pretty concerned about the first.

Stephen Lewis of Monument Securities

- 1) that delinquencies in the US mortgage market result in a series of collapses among mortgage lenders and consequent loss of confidence in the collateralised debt market.
- 2) that some over-leveraged beneficiaries of private equity capital start to default, leading to widescale cutting of credit lines to the private equity sector.
- 3) that China makes a false step in freeing the yuan exchange rate and destabilises global financial markets.

We should be very concerned about financial risks, seeing that the markets are doing so little to discount them.

John Butler of HSBC

- a. US housing market slowdown filtering into wider economy, triggering a US consumer recession and sharp global slowdown
- b. A rapid currency adjustment, with concerns about imbalances triggering a dollar collapse, with sterling, euro and yen rising
- c. A problem in the financial/household sector e.g. major hedge fund default or household credit crunch (still!)

Mark Cliffe of ING Bank

- 1. US housing market - this downturn could intensify. The unique nature of the previous boom, which was characterised by an unusual degree of speculative activity and a raft of new mortgage instruments makes the psychological responses of consumers difficult to predict. The shock of falling prices could be profound, leading to a deeper than expected impact on activity.
- 2. Oil prices - the recent comparative stability should not make us complacent about forecasters' previous inability to predict oil prices. There is a presumption that OPEC will cut output sufficiently to form a floor between \$50-60/bbl, but this could be tested if the US economic downturn intensifies. However, there are also risks on the upside, not least because of...
- 3. Geo-politics - this has sprung many of the surprises in recent years and looks set to continue to do so. The weakened position of the Bush Administration will embolden its enemies, whether terrorists (remember the 9/11 anniversary threat of Al Qaeda: they tend to carry out these threats...) or state actors.

David Miles of Morgan Stanley

Wage pressures may pick up - prompting further rises in UK interest rates; the UK housing market may turn down, perhaps sharply; and bond yields - which are still very low and globally reflect a view that inflation pressures are very well contained - may move higher. In general for the UK, most central case forecasts (including our own) do not show much of a divergence from trend growth next year. Such benign forecasts somewhat belie the risks.

Amit Kara of UBS

A) global imbalances, and by that I mean the evolution of the US current account imbalances.

What is the chance of a significant correction in 2007? In my view no more than in 2006. Indeed, the recent depreciation of the US dollar can only help narrow the gap. However, it is too complacent to dismiss the risk not least because from past experience we know that current account imbalances tend not to matter until they do and when they do, the impact can be non-trivial.

B) a sharp increase in risk aversion, which could likely lead to a drop in the price of all asset classes from art to house prices.

C) the key domestic risk, in my view, relates to the forthcoming wage settlements round. A sharp increase in wage settlements, especially if accompanied by higher inflation expectations, will likely lead to an aggressive response by the mpc.

Possible, although in my view, the slack in the labour market together with the threat of further inward migration and outsourcing will help anchor settlements at moderate levels.

What is the effect of high immigration?

Question 2. What are the two most important economic effects of high levels of net immigration? Who are the winners and losers?

Effects

Low wage inflation / inflation	28
Higher long-run growth	25
Filling skills gaps	8
Higher house prices	7
Higher demand for public services	3
Increased income inequality	2
Underestimated output	1
Overestimated productivity	1
Better living standards for immigrants	1
Higher productivity	1
Entrepreneurial	1
Added to Dom D as much as supply	1
End of EU expansion	1
Rise of the far right	1
Businesses changing higher L/K ratio	1

Winners

Companies / owners of capital	18
Everyone / Economy	13
Consumers	10
Immigrants	8
Developing countries spurred to perform better / remittances/ decrease in labour supply	4
Exchequer	4
Those who own homes	3
Well-healed	2

Losers

Lower skilled competing with better skilled immigrants	26
Problems in property market	9
Developing country skill shortages	6
None / few	4
User of strained public services	4

Continued high levels of immigration should raise the growth rate the economy can sustain without sparking inflation, holding down wages compared with profits and benefiting most people in the UK, the vast majority of economists believe.

In what was the big new issue for the UK economic analysis in 2006 even though high levels of net immigration have been with us since the turn of the decade, immigration has even persuaded the Treasury to raise its estimate of sustainable growth from 2.5 per cent to 2.75 per cent from 2007 onward.

The Financial Times panel of economists agree with the Treasury's sentiments as immigration brings more people into the labour force, allowing the economy to expand faster without creating bottlenecks and rapidly rising prices.

Ben Broadbent of Goldman Sachs said: "Faster trend growth is clearly the most important effect", while Ray Barrell of National Institute of Economic and Social Research added, "higher inward migration puts downward pressure on wage inflation, and hence reduces overall inflationary pressures whilst rising potential and actual output".

From the point of view of businesses, the effect is to ease pressures, particularly where skills are in short supply. Ian McCafferty of the CBI employers' organisation said: "Most important by far has been the impact on the supply side of the economy: allowing growth to continue beyond normal cyclical constraints, and easing skills shortages in several sectors".

The winners from this process, the vast majority of economists believed were consumers of the goods and services produced in part by immigrant labour, the owners of capital, which can hire labour cheaper than before and the immigrants themselves, who as Ian Plenderelith, a former MPC member said "get a better life".

The majority view is that the losers are those competing with immigrants for jobs, whose wages are lower than they would have been. Charles Goodhart, a former MPC member, summed it up as: "winners: capitalists, losers: workers".

Some, however, thought the facts did not fit this simple story very well. Diane Coyle of Enlightenment Economics said there was a puzzle in that the lowest skilled and the highest skilled "have experienced the fastest wage increases," which she thought showed the economy was extremely flexible with companies forming to use the new skills, high or low, that are now available. "We're all winners," she said.

But nine economists pointed out that immigration raises demand as well as supply and can cause many problems in the housing market and some public services, where supply is relatively fixed.

Richard Jeffrey of Ingenious Media said "There is little evidence that there has been any impact on the degree of excess demand in the economy", something that even the Treasury now accepts, while David B. Smith, University of Derby, said "There are clearly issues to do with pressure on the housing stock etc, but again these would be reduced if we had a sane planning system".

Other comments:

Bridget Rosewell (Chairman of Volterra Consulting)

Wage inflation kept down, output probably underestimated, but productivity may be overstated.

People with good skills are able to take jobs below their capability and keep the unskilled in unemployment - though benefit traps also play a role.

Paul Mortimer-Lee of BNP Paribas The most important effects are in boosting potential supply. This has several manifestations. The first is growth can be faster than before without sparking inflation. The way this comes about is through holding down wages. Wages (ex bonuses) have clearly been held down by the influx of labour, allowing softer than otherwise interest rates and faster growth. The other major effect – also a relative price effect is the bidding up of house prices since the demand for housing units has expanded sharply and supply is pretty much fixed.

Winners : UK economy, more growth, less inflation, lower interest rates, more tax receipts, higher housing wealth. The immigrants, who get paid more than at home, and their families. People who buy goods or services (e.g. plumbing) whose supply has increased and whose prices have been held in check) Losers: Accessions states who have seen potential growth drop. People who compete in labour market, housing market or in public services (schools, hospitals) with the new immigrants.

Philip Shaw – economist at Investec Securities

i) capping wage inflation ii) improving long-term growth prospects and stability (to some extent).

Winners - the economy, construction companies, retailers and the agricultural sectors.

Losers - low to mid skilled British workers (anecdotal evidence supports this, as do the rising ILO unemployment figures). Emerging economies, who in turn suffer skill shortages. We would note as well that the domestic economy is benefiting from internal changes such as more people of retirement age working.

Michael Hughes of Baring Asset Management

High levels of net immigration constrain domestic wage inflation and increase potential output. However in the UK at least higher participation rates by the young (result of tuition fees?) and those at normal retirement age are having a greater impact on the supply of labour than seems generally realised. Both these effects and net immigration have had a major impact on the supply and price of labour and are helping to keep inflation risks down.

Howard Archer of Global Insight

Boosting labour market supply and filling skill gaps

The winners are the companies who would otherwise have struggled to fill gaps in their workforce - either because there was a shortage of specialized skills among the available workforce or because the indigenous population were unwilling to take on particularly low paid work

Companies also win if they are able to bring in migrant workers at lower rates of pay than they would have had to pay local workers. Consumers can also be winners, in cases where immigrants lower production costs and hence prices of goods and services.

The losers are the indigenous population who are squeezed out of jobs. They can also lose out if a significant number of the immigrants in an area become a drain on social services and resources.

Gerard Lyons of Standard Chartered Bank

The benefits of immigration appear to be well known: the addition of a young, cheap and often well skilled workforce gives a boost to productivity. Usually, immigrants take up jobs that are dirty, dangerous and demeaning. In time, they move into higher value added areas. But there are downsides, particularly in the UK. There are two main types of displacement from immigration: one, is the displacement in the property market, as additional demand adds to property prices; the second, is that easy immigration and free public services do not go together. Two rights make a wrong! Immigrants put increased strain on public services, particularly in the south-east, at the expense of the domestic population.

Keith Wade of Schroeders

Stronger trend growth as the labour force increases, enabling the economy to expand at a faster rate without creating inflation.

- increased demand for housing and other services such as healthcare, education.

The winners are those who are not competing directly with the migrants in the labour market, as they share in the benefits of a stronger economy without seeing downward pressure on their pay. Losers are those who are competing with the migrants. Those countries from where the migrants originate are losing as a significant part of their young, trained and talented workforce is heading abroad.

James Knightley of ING

Reduced service sector inflation and higher economic growth. Winners are highly skilled motivated immigrants and their families, losers are the low skilled workers of the country where the immigration is occurring and I guess in the longer run the country where the immigrants come from as the migrants choose to increasingly to stay in the country they have chosen to work in.

John Calverley of American Express

Stronger growth and lower inflation. The winners are poor countries (jobs for people who move, less competition for people who stay, plus remittances) and rich country consumers. Losers are people in rich countries with competing skills.

Peter Warburton of Economic Perspectives

Again, not sure whether this question is posed generally or in the UK context. In the UK, net immigration has increased employment and output, but it has also increased unemployment, particularly in London, which now has the highest unemployment rate in the UK.

Paul Guest of Economy.com

The impact inward migration has on wages for particular skill groups is very important, and the winners here are clearly firms, who have managed to adjust to shifting input prices by compressing wage growth with the help of a supply of ready labour.

Howard Davies former MPC member and director of the London School of Economics

The main impacts in the UK have been to lift the trend growth rate a little and to moderate inflationary pressures in the labour market. Most people are winners from these effects, but there may be some displacement effect at the low end of the wage scale, as longer-standing immigrants lose jobs to new arrivals, and relative wages in sectors like construction, cleaning etc are held down.

Fionnula Earley of Nationwide Building Society

- * Impact of subduing wage growth
- * Impact on housing demand esp with UK's housing supply issues
- * More subdued wage growth should help to keep us competitive as an economy
- * First time-buyers suffer - and extra demand could inflame expectations of continued rapid increases in prices which may fuel exuberant speculative behaviour.

Professor Mike Wickens of the University of York

Housing, immigration and the environment
Rising house prices, partly due to historic high levels of immigration especially in London, are causing major social and economic disruption to life-time plans and expectations. The answer is not to degrade the environment by eating up green-belt land as this doesn't address the cause of the problem and would only ameliorate the symptoms for a short while.

Stephen King of HSBC

- a. Higher output, not just because of the increase in numbers but also because of the relatively high education and likely entrepreneurial spirit of the immigrants.
- b. Increased income inequality for the indigenous population. This is a general observations about globalisation and the degree to which it increases inequality at the national level even if it is reduced at the global level.
- c. The winners include companies and their owners (lower labour costs), borrowers (lower interest rates for a given growth rate because of lower inflation), those people living in countries who receive remittances from their migrant workers and consumers (cheaper provision of services). The losers include indigenous workers who are faced with more competition for jobs (more difficult to get pay rises these days to insulate against oil price increases), indigenous homebuyers who find that house prices are rising more quickly, those people who are unable to get, say, medical services in Africa because many of their doctors and nurses have been recruited by the NHS and, I suppose, tax payers who are supporting public spending for immigrants (although I think people make far too much of this point).

Professor Patrick Minford of Cardiff Business School

They create a source of labour market flexibility- from the new sources of supply- and secondly of entrepreneurial dynamism. In short it reinforces free markets. Provided welfare is not made available in a lax unconditional way, then there are only benefits from it.

Ross Walker of Royal Bank of Scotland

By making the supply side more flexible and responsive, inward migration is helping to the alleviate bottlenecks and contain inflation pressures - factors which, in previous UK cycles, would have resulted in interest rates being ratcheted higher and a much bumpier macroeconomic environment. As with free trade in general, the winners are widespread (most consumers) but the losers concentrated (often in vocal and influential lobby groups).

Graeme Leach of the Institute of Directors

2 most important effects have been on the supply -side, allowing higher growth and lower inflation (wage pressures) than would otherwise have been the case - most obviously in London and the South East in particular.

Katherine Booker of Oxford Economics

Boost to the labour supply allowing a higher rate of potential growth; easing recruitment pressures keeping wage growth subdued.

Winners - firms, economic migrants and the whole economy if inflation pressures are reduced requiring correspondingly lower interest rates

Losers - Unemployed UK workers who now face higher competition for entry level jobs.

Robert Barrie of Credit Suisse

It's a positive supply shock and a positive demand shock - it's possible that there are winners and losers from both and the difference between the two may be very marked at the sector and local level. Consider the difference, for example between the impact on construction (a positive supply shock) and that on housing (a positive demand shock). More generally, it's possible that this will be a less powerful influence going forward than it seems to have been in the last few years. Unemployment is falling elsewhere in Europe and other labour markets are opening up.

David Owen of Dresdner Kleinwort

Higher growth (both actual and potential) and arguably lower inflation (not so sure on this one, you can argue it both ways), so higher house prices.

George Buckley of Deutsche Bank

Inward migration has caused a positive labour supply shock, so one of the most important effects has been to keep wage pressures under control (notwithstanding recent stronger earnings numbers or what is expected to be a large bonus round). This has benefited employers, who are in a stronger position to resist higher inflation-based wage bargaining. Productivity and trend growth have probably been raised (though possibly not indefinitely) and house prices have probably been supported even more than otherwise would have been the case, benefiting existing home owners/buy to letters.

Diane Coyle of Enlightenment Economics

There's a puzzle about the effect of higher net immigration in the UK, which is why it seems to have had so little impact on the economy. After all, the number of people moving to the UK has been very large. Unemployment has increased, but not by much, and not until long after the inflow of migrants accelerated. Wage growth is lower than it might otherwise have been, but the groups facing most competition from immigrants, the most and least skilled, have experienced the fastest wage increases. The answer to the puzzle lies in the fact that the economy is relatively flexible and has adapted to the increased supply of labour. Businesses are using labour more intensively, and different types of businesses are being formed. So thinking about the economic effects in terms of winners and losers is a bit misleading. We're

all winners from the higher long-term growth rate sustainable with a growing labour force. The losses are concentrated - for example, people who want to buy a home in a place where many immigrants have bid up prices in the local housing market, whether Tower Hamlets or St Johns Wood.

Neil Blake of Experian downwards pressure on wage inflation; new lease of life for industries that looked to be in perpetual decline - agriculture, food processing

winners - companies in low pay sectors, people who need tradesmen, the economy generally
losers - unskilled workers

Marian Bell, former MPC member

Obviously growth in the labour supply, leading to faster economic growth and, in the short to medium term, lower wages and prices. Who are the winners ? The exchequer, firms, consumers (and, presumably, the immigrants). and losers? Workers, buyers/users of scarce resources such as housing, transport, space in south east.(nb the indigenous population are both winners and losers).

Jonathan Said of the Centre for Economics and business research

Growth in size of economy (more consumers) and productivity benefits. Main winners are UK business and policy makers (Treasury and Bank of England)

Malcolm Barr of JP Morgan

Two effects: Low wage growth, localised easing of quantity constraints in labour availability

Winners: the migrants themselves, households not competing with them in the secondary labour market, firms and the Chancellor

Losers: Households competing with migrant labour in the secondary labour market

John Muellbauer of Oxford University

Low UK wage growth, higher economic flexibility - hence bringing a double benefit of lower inflation, higher growth and knock on effects via asset prices etc. Winners are owners of assets and high earners; losers are the less skilled and lower earners.

Martin Weale, director of the National Institute of Economic and Social Research

Relative depression of pay of low earners and a favourable impact on the budget because immigrants probably use fewer public services and receive fewer benefits than UK subjects.

David Frost of the British Chamber of Commerce

Migration will continue to have an important part to play in the UK economy: helping to ease labour shortages in key areas, boosting employment, and helping ease inflationary wage pressures, thus reducing the need for higher interest rates. The main beneficiaries are businesses and consumers, who are able to use the increased availability of labour and skills. The potential losers are UK workers that compete directly with migrant workers, but are not willing or able to match the migrant workers in terms of skill and/or competitiveness. There are a huge number of young, white males who are leaving the UK Education system without qualifications. Unless the primary and secondary education system is transformed in this country, we are going to see a growth of a substantial underclass in the UK. It is therefore

crucial that government acts upon the recommendations of the Leitch Review to improve the skills base of the UK workforce.

Jonathan Loynes of Capital Economics

Higher trend economic growth, and lower wages growth. I guess most people should gain from faster growth, lower inflation and interest rates. The losers will be those competing with immigrants for jobs.

Stephen Lewis of Monument Securities

The two most important effects are downward pressure on wages and upward pressure on house prices. The winners are UK companies, which enjoy lower labour costs than otherwise; the losers are would-be first-time homebuyers who are continually priced out of the market.

Willem Buiter, former MPC member and London School of Economics

For host countries: joy (increased quantity and quality of goods and services) for all except those whose skills are directly competitive with those brought by the immigrants (in the UK, semi-skilled labour). For source countries; at least temporary loss of skilled labour (often employed as semi-skilled and unskilled labour abroad); benefit of remittances and future benefit from returnees equipped with capital, human capital and connections.

John Butler of HSBC

- a. supply side - rise in pool of available workers keeping lid on wages
- b. Demand side - raising demand for resources in the economy and raising price for goods and assets, like housing

Who winners/losers? In an economic sense corporates should win as the relationship between employment and wage growth improves. However, households in aggregate should benefit through keeping inflation and interest rates low, helping to support real wages. However, much depends on the economic context in which an economy is seeing these migration flows. If for instance, migration is rising in a backdrop in which employment is falling, then some households/existing workers may be displaced. If these households are heavily indebted, no income could magnify the financial stress in parts of the economy.

Alan Budd, former MPC member and Queen's College, Oxford

Net immigration raises the potential level of GDP by increasing the labour supply and lowers relative wages in those occupations entered by the immigrants. The winners are those who consume the goods and services produced by the immigrants; the losers are those who compete with them in labour markets.

Mark Cliffe of ING Bank

- 1. Higher growth - immigrants add to output
- 2. Lower inflation - in particular, by depressing the wages of the unskilled

Winners include the migrants and their families (whether they accompany them or simply receive the remittances), and the broader economy through stronger growth, lower inflation and higher tax receipts

Losers are generally workers in those sectors where the migrants are prevalent. There may also be localised concentrations of problems due to pressure on housing, social services and

social stability. The migrants' home countries suffer a loss of skills, but this is offset by remittances.

David Miles of Morgan Stanley

So far, relatively contained wage growth and probably some increase in the dispersion of wages (though the later is very hard to quantify). The winners are owners of claims upon corporate profits.

Amit Kara of UBS

The most recent episode of immigration broadly coincided with another externally induced supply shock - oil prices. Of course increased immigration is a positive supply shock, it raises gdp growth and lowers inflation while higher oil prices has the opposite effect.

A) higher immigration raises the rate of gdp growth consistent with stable inflation (ie higher potential growth). This requires the mpc to keep interest rates lower than it would have otherwise.

B) the profitability of companies attracting the migrants improves. This is probably true for the distribution, restaurants and hotels and the construction sectors.

Winners and losers: this of course depends on the skill profile of the migrants, the participation rate, the monetary policy response etc.

Overall though, gdp growth will likely be higher provided monetary policy responds. Consumer spending will rise not least because the population has risen. The new workers will also have to be equipped with tools, so investment spending will likely increase. Sectors exposed to these areas will benefit from increased demand.

From a supply side perspective, sectors that are able to hire migrant workers also benefit.

The migrants also require housing. Increased demand together with lower policy rates support house prices.

The key losers include the indigenous workforce that needs to directly compete with (cheaper) migrants. There is also some pressure on public finances to the extent that the recent increase in claimant count unemployment is a consequence of increased migration.

Are China and India a competitive threat to the UK economy?

Question: Are China and India a competitive threat to the UK economy? To what extent does higher public expenditure on education address a competitive challenge from rapidly growing emerging economies?

Opportunity (esp for consumers)	19
Both	12
Neither (this is silly)	5
Threat	4
Limited threat	4

Public expenditure on education

Only if well spent (unlikely)	13
Money wasted	9
Not just public education expenditure	6
Good and worthwhile (much better than protectionism)	5
Only if well spent (likely)	2
Highly unclear	2

China and India are not competitive threats to the UK economy, which will benefit from China's growth and integration in the world economy, according to the Financial Times survey of economists.

Only four out of 49 economists thought China and India represented a threat in a large rejection of Gordon Brown's economic strategy of trying to prepare Britain for "the next ten years [in which] the competitive challenge is even more profound".

Embodying the case against the chancellor, Professor Mike Wickens of the University of York argued that growth of these nations would change the structure of the British economy, but this has happened throughout history. "Has the loss of virtually all of the 19th century industries done any long-term harm to the UK? No. Would trying to keep them have cause harm? Yes," he said.

Professor Patrick Minford of Cardiff Business School concurred: "Of course they are no threat but instead a source of new supply complementing the UK's comparative advantage in traded services", while Sir Alan Budd, a former MPC member, thought the whole notion of countries being competitive threats was silly.

Some economists, such as Bridget Rosewell, Chairman of Volterra Consulting, said the countries were "both a threat and an opportunity", while only four, including Stephen King of HSBC, who said that China and India were "obviously" a competitive threat as they "compete in both manufacturing and services must mean that they provide additional competition.

The issue hinged less on whether the countries would provide demand for UK goods and services, according to Mr King, but in the fact that the huge increase in supply of labour from China and India threatens to exacerbate inequalities in wages which could be difficult for Western democracies to manage.

Howard Davies, a former MPC member and director of the London School of Economics, summed up a general scepticism to Mr Brown's plans to address his global challenges with public expenditure on education. Mr Davies said Mr Brown's strategy "depends on how effective our education spending is" adding that "level the issue is not just one of government spending" since the main difference between UK and US education spending is by private individuals, not government.

Paul Mortimer-Lee of BNP Paribas argued that in the long term, public expenditure on education simply would not work, since people can say "thanks for the free education and I'm off to work somewhere else".

"High skilled labour is too mobile to allow taxes on high earners to be raised, so the size of the state will have to be cut," he said.

Other comments:

Philip Shaw – economist at Investec Securities

Yes, but this is part of a long story about globalisation. A better-educated workforce would be very helpful, but I am not convinced that simply throwing money at education solves the problems we have. (Is the cash used effectively, what about social issues etc.)

Ian Plenderelith former MPC member

Yes, but more importantly also an opportunity, with an appetite for lots of high-value-added goods and services UK can supply. But yes, of course, we need advanced education to be able to take advantage of the opportunities.

Michael Hughes of Baring Asset Management

China and Indian skills and production are boosting consumer welfare and economic prosperity worldwide. Given the high level of openness of the UK economy we are a relative beneficiary of high levels of world trade.

Sufficient skills are important in moving us up the value chain. The issue is less the spend on education but rather where it is targeted. The science faculties are particularly weak and a wider curriculum requirement for secondary schools would help bridge the science gap.

UK universities are not as competitive in attracting students from overseas as that were. Education was a great export market for the UK but I believe this is beginning to decline faced with better universities in China, Australia and the US.

Howard Archer of Global Insight

China and India are a competitive threat to the UK economy primarily in specific labour-intensive manufacturing sectors. But seeing that manufacturing only accounts for some 15% of total UK GDP and also much of it is in higher value added sectors, the threat at the moment to the UK from China and India is somewhat limited. However, over time, China and India will undoubtedly become competitive threats to the UK in a growing variety of fields, including services.

Also India is a significant source of outsourcing for UK companies, which may cost jobs in the UK, but also has beneficial effects if it boosts the overall efficiency of the company.

Gerard Lyons of Standard Chartered Bank

China and India should be seen as huge growth opportunities. The adjustment phase to take advantage of these opportunities is the key to focus on. The UK needs to move quicker and further to becoming a high skilled, valued added economy, with an emphasis on areas such as the financial sector and its science base. It is vital to recognise that not only are India and China keen to move into higher value added areas, but also other economies are already adjusting.

The UK needs to ensure the right soft and hard infrastructure is in place, including low taxes, light regulation and an effective education system. Higher public spending on education does not address a competitive challenge. The lesson from the health system is that higher spending is not the answer; results and output matter.

Ray Barrell of National Institute of Economic and Social Research

Increased competition is not necessarily a threat, and is an advantage to consumers. Producers may find it easier to adapt to increased competition with a more skilled workforce, and hence expenditure on education may be helpful.

Ben Broadbent of Goldman Sachs

No. They are a competitive threat in some areas, but boost our comparative advantage in others (see attached piece!). Their rise in the world trading system has also depressed sharply the prices of many non-oil consumer goods. Looking ahead, it may be true that, because they are still relatively highly endowed (compared with the OECD) with unskilled labour, the emergence of China and India has increased the skill premium. But that may not remain true. And better education always means better incomes, regardless of whether or not we trade with China, India or anyone else.

Alan Budd, former MPC member and Queen's College, Oxford

Other countries do not represent "competitive threats" to the UK economy though they may make life uncomfortable for some UK firms. Educational policy should have little or nothing to do with something called a "competitive challenge". All the major questions would need to be resolved (and would have similar answers) if this were a closed economy.

Keith Wade of Schroeders

China is a competitive threat in the production of low cost and some higher value added manufactured goods. The UK is responding by shifting into other activities. Now some of these, such as call centres and IT services, might be threatened by India. However, the UK has a comparative advantage in many other fields - financial, legal services, pharmaceuticals, education and media and these will continue to expand and absorb workers. Government policy directed toward increasing the UK's human capital is the right response as these industries require higher skill levels. It is far preferable to a protectionist response.

James Knightley of ING

Where they produce goods/services of a like kind, yes. But the threat also keeps the UK from becoming complacent, so it is positive in this sense. Higher public expenditure on education depends on where it is spent - it is not simply enough to put more people through university when basic reading, writing and numeracy skills are still poor.

John Calverley of American Express

No. They are much too poor to be a threat to the economy as a whole in the same way that Japan or Korea can be. Though I don't really like this way of talking about it because there is no danger of being uncompetitive when you have a floating exchange rate. Higher public spending on education can raise productivity in the long run but only if it is well spent.

Peter Warburton of Economic Perspectives

Continue to regard China as a rogue economy, a giant lacking in commercial and financial discipline. While China has a huge displacement effect on Western industrial economies, thus far the West has benefited at China's expense on a net basis through the welfare effects of cheap imports. India poses a greater competitive threat in service industries because of its large English-speaking population. But I regard Gordon Brown as a bigger competitive threat to the UK economy than either China or India! His policies have sought to protect the UK from the chill winds of overseas competition through expansion of public sector funding of employment and extensions to in-work benefits. UK is less well prepared to meet overseas

competitive challenges than 10 years ago.

Ian McCafferty of the CBI employers' organisation

China and India represent both a threat and an opportunity. The addition of an increasing proportion of their labour forces into the global traded economy increases competition, shifts the balance between capital and labour and is dramatically shifting the structure and location of production, of both goods and services. At the same time, they represent an enormous potential market, growing rapidly to 2bn people, double the size of the more traditional consumer markets in the OECD and elsewhere of ten years ago.

For higher public expenditure to address this competitive challenge, it needs to deliver a level of education that allows all sections of the workforce to be adaptable and flexible in the face of fast changing conditions, and provide people with the ability to continue to learn throughout their working lives. While there have been some improvements in recent years, the UK secondary education system is still turning out too many school leavers with insufficient literacy and numeracy skills.

Paul Guest of Economy.com

No, I am of the persuasion that China and India are an opportunity, not a threat. They will certainly pose a challenge to certain industries and certain sectors, but this will help these firms grow or it will contribute to the reallocation of inputs to more productive areas. This, of course, is a long-termist view, but then if you are looking at education policy and its impact on competitiveness then you are perforce looking over a long-term time horizon. Regardless of China and India, public expenditure on education and skills is necessary. However, it has to be well targeted and this is something the current government's health care reforms have shown it is not terribly good at.

Fionnula Earley of Nationwide Building Society

* In the short term should help to bear down on inflation in goods. In the longer term we could also benefit from our experience in services

* Improving education is a central part of the famous 'endogenous growth theory' and should have the effect of increasing productive and competitive potential- but it will take a long time to bear fruit. More consideration must be put into the type and quality of education rather than just the number of people going to university.

David B. Smith, University of Derby

Fortunately, India is not a geo-political threat but probably a useful friend, and China will probably be a cautious geo-political player that will not rock the boat. The fact that China and India have come on stream is a favourable supply shock for the world economy, which has raised living standards in the West, as well as providing export opportunities. The so called competitive threat is to specific sub sectors of the economy, and should not conceal the fact that the UK benefits overall. Higher public expenditure on education has to be paid for out of higher taxes. There is considerable evidence that a high tax burden compared with one's trading partners drives the supply of tradable goods offshore (hollowing out). There is little evidence that tertiary education (or R and D) add to a country's growth potential, and the main need is for good primary and secondary education. Here Britain is spending at an internationally competitive rate, but apparently getting very poor returns in terms of attainment.

Diana Choyleva of Lombard Street Research

China offshores its financial system, which provides the UK with a unique opportunity to capitalise further on its comparative advantage in financial services.

Richard Jeffrey of Ingenious Media

In the long term, both China and India will prove competitive threats. The latter is probably a threat, even now, since it is evident that there has been a certain amount of 'contracting-out' to this area (and other low-cost areas) already. However, it may also be concluded that the jobs that have been lost are largely in low-value-added areas of the economy. To the extent that this frees up resource that can be used for the production of higher value-added services and goods, this may be regarded not as a threat but as a benefit. However, to be able to take advantage of this opportunity, the UK must ensure that it invests in education and training, so as to create a highly skilled and innovative workforce and business environment.

It will take some while before China and India compete full-on with the UK - currently, the greater threat is to countries whose economies are oriented more to manufacturing. Furthermore, as China and India become more economically wealthy and sophisticated, they will also become more important markets for Western producers.

Graeme Leach of the Institute of Directors

Competitive threat implies that trade is a zero sum game, which it isn't. The parallel growth of international trade and global GDP growth over the past 50 years surely proves this point. The UK needs to become world class across all the productivity drivers of competitiveness - education & skills, investment, innovation, enterprise and competition. The Government has a 'missing link' in its list of the drivers of productivity, namely the role of Government (taxation, spending and regulation) - there should be a 6th driver, namely the state. With regard to public expenditure on education I would refer you to the IoD's Pre-Budget Report which presented a detailed analysis of why more public spending on education wasn't justified - we developed a global education efficiency index which showed the UK as the worst performing advanced economy.

Katherine Booker of Oxford Economics

UK manufacturers already struggle to compete, and as China and India develop further the threat to business services will also intensify. But the UK is good at specialising in high tech industry and financial services, and its comparative advantage from a skilled workforce, world connections, communications technology and history should persist for some years to come. However, with increasing globalization and rapid development of emerging economies, it will be important for the UK to concentrate public investment in areas that strengthen this advantage - so spending on higher education and R&D would seem to be sensible policy.

Robert Barrie of Credit Suisse

China and India are a competitive threat in some markets and an opportunity for growth in others. As a more general observation, however, it's possible that the period in which they exerted most pressure on domestic costs and prices is behind us. The rise in the goods component of CPI inflation, for example, has been associated with a rise in import price inflation. For now, pay remains subdued, but if that were to change it might be another sign that the effects of globalisation were starting to stabilise rather than continuing to increase.

David Owen of Dresdner Kleinwort

A competitive threat?! Only to some industries/workers. Generally globalisation a good thing (everyone benefits, even in this flat world) as of course is education - although the problem here is the type of spending on education. Arguably, UK is crying out for better educated graduates, rather than simply more graduates, in particular more people skilled in mathematics, sciences and engineering, not media studies!

George Buckley of Deutsche Bank

China has been accounting for an increased share of UK imports over the past 10-15 yrs. As a proportion of total goods imports (in values) they have risen from 0.5 to 5% over that time. But there are signs of this stagnating. Still, with sterling at current levels foreign competition generally might continue to deplete the manufacturing base. The only positive is that manufacturing is worth a much smaller proportion of GDP than in the past and the service sector has stepped into the breach. Education - similar story to Brown's productivity drives - it's too early to tell, the evidence will only emerge over the long run.

Diane Coyle of Enlightenment Economics

No - businesses compete with each other but nations don't. The growth of China and India is a benefit to the UK because it expands the scope of the mutual gains from trading with them. There will be a process of progressive specialisation, and the UK will sustain its comparative advantage in sectors such as financial services, business services, and also many branches of manufacturing which are actually thriving. Even so, the quality of education in the UK will be vital to our future well-being. I don't think it will all have to be public expenditure, though. People are willing to finance some of their education and training privately if there's a return. We just have this peculiar widespread view that even though it's ok for parents to pay private school fees, or for individuals to pay MBA fees, university education should be 'free'. The important public good aspects of education seem to be concentrated in early years and primary education, as that's when children's life chances seem to be set, and their cognitive and non-cognitive abilities decisively shaped.

Neil Blake of Experian

no; higher spending on education addresses a competitive threat from all other economies not just newly emerging economies

Jonathan Said of the Centre for Economics and business research

China and India are as much as much a threat (through the upskilling of their labour force) as an opportunity given large market size. Public expenditure on education: helps address but only minimally. A free, flexible and easy environment to do business in is more important.

Malcolm Barr of JP Morgan

Yes. Whether education spending per se addresses that directly is very unclear. Coherent policy on infrastructure such as transport is probably just as important, and just as absent.

John Muellbauer of Oxford University

They are more opportunity than threat, if we can carry on moving up the value chain. We have seen skill shortages biting in both countries, where there is a tendency for quality education to be confined to elite institutions. In the longer term, as these countries address these problems, the UK needs to invest more in human capital to compete.

Martin Weale, director of the National Institute of Economic and Social Research

Yes, but the nature of the world is that there are always competitive threats. It is not clear that higher spending on education is well-focused.

David Frost of the British Chamber of Commerce

China and India clearly pose potential competitive threats to the UK economy, if we do not take appropriate steps to enhance our own competitiveness, by boosting our productivity and skills. But China and India, with their rapidly growing markets, also offer enormous opportunities to British business. Higher public spending on education is only part of the response. It must be supplemented by an overall pro-business strategy, aimed at improving skills, training, productivity and competitiveness. Higher Public spending on HE needs to be focused. We are producing too few scientists and engineers and soon we will see businesses migrating to those countries where these skills exist.

Charles Goodhart, former MPC member

- (a) An opportunity, not a threat
- (b) Not if the incentives to provide higher standards remain so poor. Money alone is not the answer.

Jonathan Loynes of Capital Economics

It's a cliché now, but the rise of China and India is both a threat and an opportunity. No amount of spending on education is going to allow the UK to compete on cost with developing countries. But China and India are also increasingly valuable markets for UK exports.

Stephen Lewis of Monument Securities

There is a transitional problem for the UK, however, in transferring resources from slow-growing UK sectors to activities which promise faster expansion and better returns. Higher public spending on education may help this process but the gains could be no more than marginal unless training courses are carefully matched against potential employers' requirements.

Willem Buiter, former MPC member and London School of Economics

They are both a competitive threat and a massive market opportunity. Higher public expenditure on education will only help if it actually increases the quantity and/or quality of education and skills. Without major changes in incentives in the education sector (at all levels, from primary to university), increased public money will simply disappear into the pockets of the incumbent producers.

John Butler of HSBC

China/India can be a competitive threat or used as a competitive advantage. So far companies in the UK are using it as an advantage. The challenge is establishing a comparative advantage in high-valued added sectors. That implies education is key. But it is not about measuring success by how many degrees children receive. But rather about filling the skill gaps that will be needed in future, in the sectors the UK chooses to specialize in.

Mark Cliffe of ING Bank

Yes, but less than they are to many other Western European economies with comparatively large manufacturing sectors. They are also an opportunity for our knowledge-based and travel industries. Higher spending on education may help, but it is more a question of what kind of education we are targeting. An active programme of teaching Chinese and Indian languages might be more useful than a generalised splurge, or a massive programme of new school building.

David Miles of Morgan Stanley

Importing goods from China and India have generated great gains in welfare for UK households in aggregate as the terms of trade have improved and low cost imports have kept inflation and interest rates low. The challenge for the UK remains trying to improve the skills and productivity of the less well educated.

Amit Kara of UBS

India and china are a threat and enhancing the human capital in the uk by way of public expenditure is an important but by no means the only action that the government can take. Maintaining and creating first-class infrastructure which also includes promoting a competitive and open business environment is key for attracting companies and entrepreneurs to the UK.

Universities must also be encouraged to become centres of excellence for research and encouraged to work with industry.

Is the housing market sustainable?

Question: The housing market rebounded in 2006. To what degree do you think we are experiencing a rise in the sustainable level of house prices, or irrational exuberance in markets?

Sustainable	17
Both	13
Irrational Exuberance	11

House prices are sustainable at the current high levels, the majority of economists now believe as many have ditched previous forecasts of impending house price falls.

While two years ago three-quarters of economists surveyed by the FT thought a housing market downturn was a serious risk for the economy and last year, the vast majority still thought prices were still too high, 30 of 41 economists at the end of 2006 thought much of the rise in prices was sustainable. Only 11 thought the market was experiencing irrational exuberance.

Those most confident about their housing market forecasts were the economists who always thought the market was sound. Diana Choyleva of Lombard Street Research said "at current levels of incomes and mortgage rates UK house prices are affordable", while Jonathan Said of the Centre for Economics and business research added that "the lack of housing supply and the continuous growth in demand, boosted not least by migration and low interest rates" underpinned prices.

Among economists who have looked again at the market in recent years, it is as Philip Shaw of Investec Securities described, the rise in the number of households and low nominal and real interest rates that have supported the market. Amit Kara of UBS thought that prices were now reinforced by "a belief that the MPC will likely lower interest rates to cushion a sharp blow to house prices".

Some economists representing housing-related organisations were also confident. Milan Khatri of the Royal Institution of Chartered Surveyors said that when strong housing demand meets "woefully inadequate" building levels, the price is "well supported". But others, including Fionnula Earley of Nationwide Building Society suggested there was also an "element of speculation as people fear losing out in the future if they don't get in now".

This speculative element also concerned the minority who thought the housing market was overpriced. Michael Hughes of Baring Asset Management said "real house prices have deviated dramatically from their long-term trend and seem out of line with other financial assets", while John Calverley of American Express said bubble conditions existed but would burst "only when we get a major economic downturn". David Miles of Morgan Stanley warned that "we should not have much confidence that the economic fundamentals explain most of the price appreciation seen in recent years".

Quite a large number of economists were willing to sit only on the fence, with Howard Archer, of Global Insight, for example, calculating that the rise in prices is a mixture of sustainable and unsustainable elements. Equally many agreed with Stephen King of HSBC that the market seemed a bit mad, but he confessed they did not understand what was going on.

But even among those who saw no bubble, such as Willem Buiter, the former MPC member, warned all asset prices, including housing were high and "when these anomalies are corrected, housing prices will drop also".

Other Comments:

Martin Weale, director of the National Institute of Economic and Social Research

Land prices are very high and yields are low. Just as interest rates have returned to more normal levels, so too I expect yields on residential property to return to more normal levels, implying slow growth or falls in house prices. But I have no idea when this might happen.

Malcolm Barr of JP Morgan

I do not believe 'bubbles' and irrational exuberance' type labels apply -if some, why has the market held up through two big slowings in demand?

Ben Broadbent of Goldman Sachs

The rental price is clearly the single best measure of supply/demand effects. And while rental yields are slightly below 3-year ex ante real rates (relative to the 25-yr average spread between the two), they are not THAT much below. To forecast a crash, it seems to me, you need to forecast a general (and probably therefore global) rise in real interest rates. Possible, but non-specific to the UK or to housing.

Howard Davies former MPC member and director of the London School of Economics

I cannot understand house prices in London and the south east, but i have been expecting a correction for some time, so my views are worth little!

Stephen King of HSBC

It all seems rather mad at the moment, but I wonder whether the influx of immigrants has made traditional valuation metrics less reliable.

That does not mean the high level is sustainable. Some of the rise in house price represents the capitalisation of low real rates and a very stable UK economic environment into house prices - both of which will be challenged at some point in the coming decade.

Bridget Rosewell (Chairman of Volterra Consulting)

We have already experienced the rise in prices which goes with a lower interest rate regime than previously experienced. Further increases are more reflecting the slow rate of house building, as well as increasing demand for better and larger houses. Planner bemoan the fact that single people buy and occupy 2 bedroom apartments. But that is their choice. Whether the level of excess demand can continue to keep prices high or whether an economic slowdown in general terms will trigger a collapse is more of a moot point. It will turn on whether both interest rates and unemployment rise together.

Ian Plenderelith former MPC member

Some of the buoyancy (houses for investment bankers in Chelsea/Kensington) is part of the international property market and nothing to do with the UK economy (any more than house prices in Palm Springs are anything to do with the US economy, or in the S of France for the French economy or in Cape Town for the South African economy). The mainstream domestic market does not strike me as excessive given the extended economic growth of recent years.

Gerard Lyons of Standard Chartered Bank

The demand-supply imbalance suggests that house prices can continue to trend higher, but the pace of price rises suggests that there is some excess speculation.

Ray Barrell of National Institute of Economic and Social Research

Both, with London markets supported by external demand and all markets supported by excess liquidity and lax financial controls.

Keith Wade of Schroeders

The drivers are healthy, employment growth is strong and interest rates are low, but house prices are still overvalued suggesting a significant element of irrational exuberance.

James Knightley of ING

Bit of both, structural undersupply is helping to fuel speculation.

Peter Warburton of Economic Perspectives

Housing market rebound in 2006 owed much to the surge in Buy-to-Let, other forms of residential property investment and foreign buyers. There was a muted rebound in conventional Buy-to-Dwell. The price appreciation was driven largely by investors. Difficult to find accurate information on composition of transactions. Investors are more ready sellers in softening markets than dwellers. I think the next UK economic downturn will see an exaggerated drop in average UK house prices with many regions experiencing annual price falls.

Ian McCafferty of the CBI employers' organisation

House prices, like many other asset classes, are being driven in part by the abundant levels of liquidity created in recent years. To that, in the UK, add a structural shortage of supply, due to planning constraints. In addition, housing demand is less directly linked to average earnings than in the past – generational wealth transfer, rising real incomes, two-earner families and economic stability (and low nominal interest rates) have allowed purchasers to become more highly leveraged or to bid for higher priced houses. For many, housing has become a luxury good, in that as real incomes rise they are prepared to spend an increased proportion of their income on it – a sociological rather than an economic phenomenon. All of these have contributed to house price inflation rather faster than overall inflation. As long as these factors persist, much of the recent gain is sustainable, though that is not to say that the current rapid rise in prices can continue unabated.

Paul Guest of Economy.com

Over the past decade, both inflation and interest rates have fallen and become more stable, while at the same time job creation and income growth have both been very strong. This argues in favour of a permanent upward shift in the sustainable level of house price growth. The rebound occurred sooner and more rapidly than we anticipated, and we think there is a measure of over-exuberance, particularly in the southeast and in parts of the buy-to-let market.

Professor Mike Wickens of the University of York

Housing demand exceeds supply. More needs to be done in the long-term to demand and immigration and less emphasis should be given to supply unless it is real brown field sites. I would aim to renew our cities, admittedly partly a public good. This would also cut down on travel and congestion.

David B. Smith, University of Derby

Both to some extent (see comment on immigration). However, the role of housing as collateral means that there is a feedback from rapid money and credit growth to house prices (and activity) back to money and credit growth in the next period. I expect the DCLG house price index to raise by 5.3% in the year to 2007 Q4, and 1.4% in the year to 2008 Q4, but to fall by 0.9% in the year to 2009 Q4.

Professor Patrick Minford of Cardiff Business School

It is sustainable. The housing market in the UK is starved of land and yet with immigration, rising labour market participation and steady productivity growth, the rise in incomes is channelled heavily into housing demand.

Richard Jeffrey of Ingenious Media

For years, economists have been publishing pictures that show house prices, and debt, rising to seemingly untenable levels in relation to income (and have been drawing the conclusion that the housing market must spontaneously implode). Either households have been behaving irrationally over this period (since about 2001), or economists have been drawing the wrong conclusions. I think the latter is true. The more important relationship to look at is debt interest in relation to income. This does not look untenably high. Indeed, it implies that house prices could continue to rise. The same conclusion can be drawn when household liabilities are measured in relation to assets.

However, were interest rates to rise sharply - and by more than currently anticipated - the housing market would undoubtedly experience a period of weakness. However, this would be cyclical rather than structural.

(NB This does not mean that rapid increases in house prices have been a 'good thing' - merely that in current circumstances, they do not look too high.)

Graeme Leach of the Institute of Directors

We err more towards irrational exuberance than a sustainable level of house prices, given that the HP:Y ratio on the Halifax measure is nearly 6, against a long-term average of 3.8. Even allowing for structural changes (land supply constraints, household formation, low interest rate environment) it is difficult to believe that the sustainable ratio has increased to 6 within the past decade. Consequently the issue becomes what is a sustainable new ratio 4, 4.5, 5, 5.5? Economists simply don't know the answer here. If we assume it's around 5 or less, the question then becomes how we get there. Do prices flatten out and incomes catch-up over many years, or is the process much more concentrated, with nominal house price falls and the pain concentrated into a couple of years? Again we can't be certain because we only have one data point, the housing recession of the early 1990s, which was set against a radically different interest rate environment. House prices flatten and incomes catch-up over many years is the most likely - but boring scenario!

Katherine Booker of Oxford Economics

Further easing in lending constraints and greater flexibility in mortgage finance suggests there has been some rise in the sustainable level of house prices. But prices have a tendency to overshoot due to the role played by expectations, and as housing is increasingly demanded as an investment asset, the role of expectations has strengthened. Therefore it would not be surprising if the market went through another short period of stagnation if interest rates keep rising.

Robert Barrie of Credit Suisse

It's probably a bit of both. It's clear that houses are expensive in relation to current household incomes, but also that the prospective returns from long-duration index-linked assets are highly valued in a number of contexts at present. It may be that house prices are sustainable while long-dated real yields are at these low levels but that they would not be sustainable if the latter were at higher levels. The big question then - which concerns all assets - is are these long-dated real yield sustainable. The answer is probably not for ever, but almost certainly for a bit longer.

David Owen of Dresdner Kleinwort

If interest rates do not rise much further, today's level of house prices at a national level could well be sustainable - with house prices basically moving sidelines for an extended period of time, precisely as much of London experienced between 2000 and 2004. Likely to be associated with much weaker transactions. So house prices to incomes deflate somewhat. But risk has to be a more pronounced correction at some point which MPC reacts to by cutting rates. Not helped by long (variable) lags involved between rate changes influencing housing. If banks were to turn off the tap, then.....Not convinced by notions that it is all a speculative bubble. How many people buy a house for short-term capital gain? More likely that even if they believe there is a risk of any short-term weakness in price, they are in it for the long-term. Rising unemployment and problems servicing debt the real killer.

George Buckley of Deutsche Bank

It is probably a bit of both. Yes, the equilibrium house price should be higher now on account of lower real interest rates, increased household formation and previously low new supply. But asset prices have a tendency to overshoot, and a correction seems likely at some point in the future, in our opinion, via a long period of house price growth below that of household earnings. A slowing in HP inflation seems likely later in 2007.

Paul Mortimer-Lee of BNP Paribas

The influx of wealthy individuals at the top of the scale from abroad has boosted house prices, particularly in London. With house prices high and Russian elections looming, demand from this quarter should remain strong. At the same time prospectively good City bonuses are boosting house prices in the SE. Moreover, increased demand from immigrants from accession countries is pressuring the market. With risk premia in financial markets low, interest rates subdued – and unlikely to rise significantly, with every prospect of a fall next year - and housing supply severely restricted, the resurgence looks justified by fundamentals. Basically, if demand rises sharply relative to supply, as it has, prices per square foot have to rise sufficiently to encourage more people to live in smaller units or to price them out of the market. Like the oil market, prices rise significantly in the face of demand shocks because supply is very inelastic. Big price increases are rational rationing devices.

Neil Blake of Experian

irrational exuberance

David Frost of the British Chamber of Commerce

This is a very complex issue and there are disagreements between experts. We believe that in recent years we have seen both a rise in the sustainable level of house prices, as well as an element of speculative housing bubble in some areas of the country.

Charles Goodhart, former MPC member

If interest rates rise (as they will, see 3(a) above) the market will cool. If not, not.

Jonathan Loynes of Capital Economics

There does appear to have been some increase in the sustainable level of house prices, but we still believe that prices are significantly overvalued. The danger of a sharp downward correction at some point has not disappeared altogether.

Stephen Lewis of Monument Securities

There are significant structural factors, including inward migration, reduction in average household size and constraints on new supply to keep house prices buoyant. Irrational exuberance is probably playing only a small part overall in pushing house prices higher.

John Butler of HSBC

A bit of both. Unexpected rise in workforce supports rise in house prices. But house price to rent and house price to income suggest valuations are not sustainable. The question what will be and when will the trigger come.

Mark Cliffe of ING Bank

The price rises are probably sustainable. Ahead of the next election there seems to be little enthusiasm for radical action to free up the supply of building land or loosen planning restrictions.

6. Are the public finances sufficiently healthy? Should public expenditure plans be modified in the 2007 comprehensive spending review?

Unhealthy	22
Healthy	8
Other things imp	1

Spending should be cut	15
More productivity	6

Gordon Brown should reduce public expenditure to reduce public borrowing, a large majority of economists believe and almost none use the chancellor's fiscal rules any longer as an indication of the health of the public finances.

Even after a series of tax increases after the election, the experience of government public finance forecasts being too optimistic led almost three-quarters of the economists surveyed to say the government's finances were still not strong enough.

With little room for above average non-inflationary growth, Jonathan Loynes of Capital Economics said "the public finances are not healthy and some action will eventually be required to put them back on a sustainable footing". Stephen Lewis of Monument Securities noticed that "the UK is recording no reduction in budget deficits whereas France, Germany and even Italy are making progress in strengthening public finances". Neil Blake of Experian agreed with the International Monetary Fund that the finances were "still on a bit of a knife edge, especially if the economy were to slow down significantly".

George Buckley of Deutsche Bank no longer trusted the chancellor's forecasts, which show the finances to be healthy. "Mr Brown has generally been wrong on the low side in forecasting the budget deficit, and we have little reason to think things will be different going forward". Peter Warburton of Economic Perspectives, similarly said that with "off-balance sheet items such as the private finance initiative and public sector unfunded pension costs ballooning" the true state of the finances is worse than it appears.

Those that are less concerned point out, as did David Owen of Dresdner Kleinwort that the level of public debt was "excellent", but he still felt that "clearly size of budget deficit becoming an issue".

Of the minority who thought the finances were fine, John Butler of HSBC said that the level of public borrowing "are healthy when put in a historical or international context" and that the forthcoming spending review "will probably keep constraints on spending". Katherine Booker of Oxford Economics had little faith in the Treasury's forecasts but said the Comprehensive Spending Review "already looks like it will deliver a fairly severe haircut to public admin spending".

On the action to take, the economists spoke with near unanimity in suggesting public spending has grown too quickly and either should fall as a share of national income or more effort should be put on better rather than more spending.

Graeme Leach of the Institute of Directors described the past six years' rise in public spending as "unprecedented" outside a major war and it "needs to be put on a downward path". Paul Guest of Economy.com added: "The spending plans should definitely be modified in the Review as the government is going deeper and deeper into the red in structural terms".

While Malcolm Barr of JP Morgan thought the problem in the finances is not large, he added "the key challenge is not spending restriction, but better spending".

Bridget Rosewell (Chairman of Volterra Consulting)

In general, the golden rule(s) have provided some useful disciplines. But the finances are now too bloated and risk killing the golden goose.

Moreover, where investment spending is hard to do without government (in our current asset mix), the borrowing rule may turn into a foolish straitjacket.

The CSR still relies on each department to make its own decisions about what it should control hardest. Self interest means that it takes a long time to see and act where it is necessary - look how long it has taken to do something about the Child Support Agency.

If plans are not modified, the review doesn't mean anything. The main worry is that it is not really comprehensive.

Philip Shaw – economist at Investec Securities

No. Net borrowing close to £40bn during an economic downswing is one thing. A £40bn deficit when the output gap is zero is quite another, and makes me uneasy.

Yes, there should be more spending restraint, but it will not happen on top of the slowdown which is already pencilled into the projections beyond 2007/08.

Michael Hughes of Baring Asset Management

The efficiency of public spending is questionable and hence without signs of greater productivity from the public sector the justification to maintain current spending plans is questionable. I sense a growing debate about pension entitlements in the public sector with growing resentment from the private sector. Pension reform could go a long way to bring future public sector spending in line with the growth of the economy and help rebalance public spending from current to capital investment.

Howard Archer of Global Insight

No, the public finance forecasts look optimistic to us. Sooner or later stronger action is likely to be needed - either through even stricter cuts in public spending growth, increasing taxes, or very possibly a combination of the two.

Gerard Lyons of Standard Chartered Bank

The public finances are healthy, but they probably should be healthier, given how strong recent growth has been. In terms of public spending, the Chancellor has gone from a famine (in his first few years), to a feast and is now planning a diet in this Comprehensive Spending Review. Diets rarely work, a change in lifestyle is needed, and that requires a greater focus on productivity and results in the public sector.

Ray Barrell of National Institute of Economic and Social Research

Public finances remain marginally unhealthy even after recent tax rises. More tax increases would be wise, as expenditure needs still exist in the minds of voters.

Ben Broadbent of Goldman Sachs

Don't think borrowing matters that much - the LEVEL of spending and taxation, in the empirical growth literature, matters much more than the difference between them (not what Martin Wolf wrote last year but nonetheless true!). Current spending on public services, per head of population, is now 20% higher in the UK than in the EMU4 countries (30% at market exchange rates). But our public services are still relatively poor. The clear priority is to improve their performance with existing financial resources, not to pump yet more into them. So I hope the government can stick to its relatively tight plans.

Keith Wade of Schroeders

The government, like borrowers elsewhere have benefited from a period of low real interest rates, but this may not last for ever.

James Knightley of ING

Not as healthy as they were. Spending is out of hand and the government is failing to get to grips with the cost cutting. Given where we are in the cycle, the public finances should be in far better shape.

John Calverley of American Express

No - the budget deficit at close to 3% of GDP on international definitions is far too large for this stage of the cycle. It does not matter from a fiscal sustainability point of view - in fact the market wants the gilts - but it leaves no room for expansionary fiscal policy in the event of a shock recession. Spending needs cutting.

Ian McCafferty of the CBI employers' organisation

Although it is unlikely that the "golden rule" will be breached in the foreseeable future, the underlying state of the public finances is a cause for concern. Current deficit levels can only be justified if there is a significant degree of slack in the economy. Moreover, the tax burden required to finance the level of public spending is still rising, and will reach 42.5% of GDP in 2007/08, up from 38.7% only seven years ago. For the corporate sector, this is already eroding their international competitiveness, and leading to an increasing number of companies questioning whether they should relocate outside the UK. In terms of the CSR, greater discipline in spending practices and management would allow the annual rate of growth of real terms spending over the next three years to be reduced from 1.9% to 1.6% without hitting frontline services, to the benefit of the public finances overall.

Howard Davies former MPC member and director of the London School of Economics

I believe spending is too high. In the 15th year of expansion we ought to be running a surplus. I suspect the next CSR will be tougher than many expect - at least it ought to be.

Fionnula Earley of Nationwide Building Society

* Government finances are ok in general.

Professor Mike Wickens of the University of York

The question is: are there sufficient public goods to justify the government to spend as much of our money for us? The answer is NO.

Stephen King of HSBC

On the basis of debt/GDP ratios and the size of borrowing, the UK compares favourably with many other industrialised nations. But I'm worried about effective off-balance sheet liabilities which are a hidden burden on future generations. I'm even more worried about the lack of any focus on the efficiency with which spending is carried out. If there is no reliable measure of health output, then how on earth do you know that taxpayers' money is being spent wisely? The increases in public spending are an act of faith, not an act of economics.

David B. Smith, University of Derby

Prime Minister Brown is likely to inherit the worst fiscal situation of any new Prime Minister since either 1979 or 1974, take your pick. Enforcing the slow spending growth set out in the CSR will be a massive achievement, given the starting point, but Britain has now 'achieved' one of the worst structural fiscal deficits in the OECD. It is also probable that the country has now reached the economic, if not political, limits of taxation, and that higher taxes would increase the deficit not

narrow it.

Professor Patrick Minford Cardiff Business School

No they are not and yes they should. The finances still show a 3% deficit; added to the contingent liabilities represented by PFI and the explicit liabilities of public sector pensions, the UK is drifting back into fiscal incontinence, on the back of a sharp rise in taxation.

Wynne Godley of Cambridge University

I have not had time to work out a considered view about fiscal policy and public expenditure in the UK in 2007. I do however think (and always have thought) that the Golden Rule is fundamentally mistaken (to use no stronger term) - as is any attempt to run fiscal policy in terms of a target for the budget balance measured ex post facto. Where would the US economy have gone if there had not been a vast increase in the deficit at the beginning of the century (I think it was 2001)? In other words I think, as a general point, that fiscal policy should be rehabilitated so as to complement monetary policy in the management of the economy. So I suppose my answer to your question is that public expenditure should not be cut unless the state of the economy requires this to happen (which it probably doesn't).

Richard Jeffrey of Ingenious Media

After fifteen consecutive years of economic expansion, the public sector accounts should not be showing a deficit equivalent to 1½% of GDP. Public finances have deteriorated, and the Treasury's insistence otherwise is not to its credit.

However, both political parties have to face up to a conundrum - that as economies become wealthier, they spend higher proportions of income on education and health (and, in current circumstances, we are likely to have to spend more on defence). While recent spending increases may not have been well-targeted, therefore, higher spending will be a long-term trend - but it has to be matched on the revenue side of the accounts.

At the current time, it would seem that the private sector provides better quality services in education and, in a more limited range of areas, in health. But there is a relatively small proportion of the population that can access private sector provision. The population will be convinced that higher public sector spending is acceptable only if the quality of outputs begins to measure up to that from the private sector. Alternatively, the politicians need to come to a consensus with regard to how we can extend access to the private sector.

Unless this happens, successive governments will face the same dilemma - that the population requires improved services from public sector health and education provision, but is not willing to pay for it. (In this context, the moves towards the direct taxation of services usage - e.g. roads - may eventually cause a re-think of how we pay for a broader range of services.)

Ross Walker of Royal Bank of Scotland

UK public sector deficits appear a little bloated, especially on a cyclically-adjusted basis. But institutional investors' voracious appetite for government debt means the financial markets are unlikely to impose any real sanction in the form of higher yields. Pension fund demand for longer-dated paper will ensure the sterling yield curve remains inverted - metaphorically, the gorilla hanging at the end of the branch is unlikely to be dislodged any time soon.

Robert Barrie of Credit Suisse

The public finances don't seem to have done as well as they should over the past year. That could change - they did better than we could easily explain over the previous year. The problem - if there is a problem - is that there only seems to be limited feedback from whatever they do to policy. It shouldn't follow every twitch in the numbers, but there must come a point when they have some impact and we have yet really to see that.

Paul Mortimer-Lee of BNP Paribas

According to the PBR the output gap is pretty much closed, which means that all of the budget deficit is structural. Given nominal GDP growth of around 5% p.a. the current level of the deficit is consistent with a debt/GDP ratio of over 60% in the longer run. However, A single year's deficit cannot be said to be 'too high or too low' – the run of future surpluses and deficits will determine sustainability over the cycle and the compliance with debt targets. Since the PBR envisages a narrowing of the government's current deficit, there is the implication that the present current deficit is larger than desirable.

With inflation above the target, the probability in the next few years must be for growth below rather than below potential (since presumably above potential growth would worsen the current inflation problem while a period of growth at least a little below potential may be needed to get rid of it).

Jonathan Said of the Centre for Economics and business research

No not healthy. Expenditure as a share of GDP continues to rise, whilst it is declining in Europe. This ratio and tax/GDP should ideally be reduced to around 35%. Privatising areas such health whilst giving vouchers to lower income households, would be a good start.

John Muellbauer of Oxford University

I'm fairly cynical about the accounting conventions around PFI which disguise the true level of public expenditure commitments and which have sometimes resulted in higher long term resource costs. These make a nonsense of the 'golden rule'. That said, it is fairly obvious that further fiscal tightening has to occur.

Martin Weale, director of the National Institute of Economic and Social Research

The current budget is probably on a sustainable trajectory. But the budget should be in surplus as the Government's contribution to filling the savings gap.

David Frost of the British Chamber of Commerce

UK public finances are still significantly over-stretched, and the recent Pre-Budget Report (PBR) does not remove the threat of additional tax increases in the next 2-3 years. Public expenditure plans should be modified in the 2007 comprehensive spending review (CSR) in order to achieve two main aims: Remove the threat of additional tax increases. Rebalance spending towards boosting enterprise, innovation, competitiveness, and wealth creation.

Charles Goodhart, former MPC member

- (a) No
- (b) Yes, but only for future years; not for 2007

Willem Buiter, former MPC member and London School of Economics

No, the IMF is right. If there were to be a cyclical downturn, the automatic stabilisers probably would not be able to function properly without violating the sustainable investment rule (net debt less than 40% of annual GDP) or endangering the golden rule. In addition, the seven percentage points of GDP increase in the ratio of public spending to GDP of the past five years does not represent value for money. A structural reduction in the size of the public sector is called for.

Alan Budd, former MPC member and Queen's College, Oxford

The public finances are OK, though they are not as strong as one might have hoped.

Mark Cliffe of ING Bank

On the Chancellor's own rules, yes, but the fact that the growth in public spending is finally being reined in is a sign that outside criticism is having an effect. However, unless the Conservatives adopt a more radical approach, the Government is unlikely to change the direction of public finances.

David Miles of Morgan Stanley

There isn't any immediate pressure on the fiscal rules, but fiscal consolidation in some form may be needed in coming years to put the public finances on a surer footing.

Does it matter who occupies No 11?

Gordon Brown will not be chancellor this time next year. Who will be the next chancellor? Who should be the next chancellor? Does it matter?

Who will be the next chancellor?

Alistair Darling	15
Ed Balls	12
Gordon Brown	1
Alan Johnson	1
Ruth Kelly	1

Does it matter?

Gordon Brown will control things from No. 10	20
Yes	8
No	7

Economists who follow the Treasury most closely think that Gordon Brown will find it terribly difficult to hand over the reins of economic power to someone else.

Asked whether it matters who is the next chancellor, a clear majority said the question was irrelevant as Gordon Brown would not give his successor the freedom to set policy that he enjoyed.

Martin Weale, director of the National Institute of Economic and Social Research, said simply: "I assume that the real next Chancellor will be Gordon Brown", while Stephen King of HSBC, Willem Buiter, the former MPC member and Ross Walker of Royal Bank of Scotland all made the joke that the prime minister as First Lord of the Treasury will lord it over the next chancellor.

Though the overriding belief is that Mr Brown will still be in charge, Alistair Darling is favourite to get a promotion to become the next chancellor with half of the economists who expressed a view suggesting his name.

Ed Balls, the junior Treasury minister and Mr Brown's close adviser, was named by 12 economists, some two in five of those who expressed a view. The other names getting one vote each were Ruth Kelly, Alan Johnson and Gordon Brown himself.

If Ed Balls were to be promoted to No 11, it would seal a remarkable rise for the chancellor's former adviser and would indicate that Mr Brown intends to keep his most loyal ministers in the most important economic jobs.

Other comments:

Bridget Rosewell (Chairman of Volterra Consulting)

Alistair Darling would be my bet, but it seems a pretty open field. I don't really have a view on who it should be, but would like to see someone who is prepared to stand back and realise that less is more. Fewer plans, shorter reports, less micromanagement.

Philip Shaw – economist at Investec Securities

Ed Balls, I suspect will be. Alistair Darling, perhaps should be for a while. My own feeling that despite knowing the policy ropes inside out, Ed Balls may not yet have the political experience to be at no.11 and fighting an election which could even take place in 2008. So yes, it does matter.

Michael Hughes of Baring Asset Management

My guess of who will be the new Chancellor is Alistair Darling which would mean that No 10's control of the Treasury would be greater than in recent years.

Howard Archer of Global Insight

Ed Balls will be, and should be, the next chancellor. I suspect it will not matter too much as I believe Gordon Brown will maintain a strong interest in running the economy and seek to strongly influence whoever the Chancellor is! The Chancellor will clearly be someone on the same wavelength as Brown.

Gerard Lyons of Standard Chartered Bank

Who will be? Darling (best guess) or Balls

Ray Barrell of National Institute of Economic and Social Research

Do not know, do not have an opinion, and let us hope they are competent

Ben Broadbent of Goldman Sachs

Darling; and probably not. Brown will be a pretty powerful PM anyway.

Keith Wade of Schroeders

Whoever takes over is unlikely to have much of a free hand. Ed Balls seems to be the most likely candidate.

James Knightley of ING

Next Chancellor - Ed Balls? Who should it be? - Gordon Brown (keep him out of trouble!!) - probably best not to mention that. Does it matter? -depends how much freedom the new person is given. I suspect not very much making Ed Balls the most likely choice.

John Calverley of American Express

I think it does matter because Gordon Brown will be busy with lots of other things. My best guess is Ed Balls, who is eminently qualified, but that may not fit with the politics of it.

Peter Warburton of Economic Perspectives

I expect Alistair Darling to become the next Chancellor, but obviously Ed Balls is also a contender. Have no strong convictions over who should be Chancellor and have some doubts whether the position will continue for much longer. Possibility of a new finance ministry and splitting of Treasury functions.

Ian McCafferty of the CBI employers' organisation

The key question is whether Treasury continues in its current form, post-Brown. However the management of the economy is structured within government, we need someone with an understanding of the pressures and changes the economy is undergoing, and who is prepared to put the competitiveness of our economy at the forefront of his or her thinking.

Howard Davies former MPC member and director of the London School of Economics

Alistair darling. He will not set the world alight, but the other candidates are not strong either. How much it matters depends on the treasury's functions post Blair, i.e. will brown take strategic control of economic policy with him to number 10. I suspect he will.

Fionnula Earley of Nationwide Building Society

* It probably doesn't matter as much as in the past as monetary policy is no longer part of the remit. In addition, Gordon Brown set a precedent by talking a lot about fiscal prudence which any successor would have to maintain to some extent.

Professor Mike Wickens of the University of York

It doesn't matter as Brown will still be the effective Chancellor.

Stephen King of HSBC

Alistair Darling is my bet, but I don't think it's that important. The First Lord of the Treasury will have the dominant role!

David B. Smith, University of Derby

Next Chancellor will presumably be Darling or Balls. It does matter because the public finances are not healthy and it will require a first rate political bruiser to maintain spending discipline given the extent to which the growth of spending is supposed to be reined back. It will also be important that the FOREX markets trust the new Chancellor. This will not be a job for a second ranker or a wimp.

Professor Patrick Minford Cardiff Business School

Yes, it does matter. I think it will be Alistair Darling who is competent and could possibly be good. We need a Chancellor who understands the supply side that is, the springs of entrepreneurial growth, lying in incentives and therefore low taxation especially on business activity. The current Chancellor has failed lamentably in this, and has presided over a damaging rise in taxation.

Wynne Godley of Cambridge University

I'm not frightened that inflation will take off next year but all thoughts of a new Chancellor do make me feel a bit queasy.

Richard Jeffrey of Ingenious Media

Gordon Brown will almost certainly not be Chancellor in a year's time; almost certainly, he will be Prime Minister. While Alistair Darling is widely touted as the next Chancellor, Alan Johnson must be considered a strong candidate - probably in front of the D Milliband and E Balls. I am not sure who, as an individual, it should be. But it is to be hoped that it is someone who is able to display

independent, forward thinking, and who is not constrained by historic political dogmas and jealousies.

Almost certainly, the relationship between No.10 and No.11 will remain tetchy. The next Chancellor will be the one who has to take steps to close the structural current deficit in public sector finances, and there is no doubt that Mr Brown, as PM, would want to have an influence on any decisions in a way that he has never tolerated from Mr Blair.

Who occupies the Chancellor's seat is important. We require a change in thinking away from the 'money solution'. Higher spending on government services does not necessarily produce higher quality or quantity output (long term, more money is necessary, short term it is far from sufficient). Areas such as education and health have not shown the improvement that might have been anticipated when spending was raised so aggressively.

It is also important that the corporate tax regime is simplified and made more competitive in order to attract overseas investment into the UK and to help UK industry compete.

It is too much to hope for that personal taxation will be reformed. Tax credits (which benefit many higher income earners) should be unwound and the money targeted at those who need it. Also, the amalgamation of Income Tax with National Insurance would make for a more transparent system - and also one that could be reformed more easily.

Ross Walker of Royal Bank of Scotland

The Prime Minister is 'First Lord of the Treasury' and as the incumbent of No.10 Mr Brown is likely to apply a fairly liberal interpretation to this nomenclature.

Graeme Leach of the Institute of Directors

Tricky one. I think Balls will be Chief Secretary, but I also doubt whether Darling will be Chancellor (too many Scots accents at the top etc) even though he seems most likely. Does it matter? In the short-term probably not, since the CSR will have been decided, Brown will still dominate having had 10 years experience in No. 11, fiscal rules in place etc. The difficulty here is that nobody other than the Chancellor has spoken on economic policy for the entire Labour period and so we don't really know where others might want to go. No radical changes are likely, but a shift in emphasis is possible, depending on the incumbent.

Katherine Booker of Oxford Economics

Plenty of speculation that Ed Balls could be the next Chancellor, currently a junior minister at the Treasury and Gordon Brown's right-hand man for many years. But a jump from junior minister to Chancellor may be too big a step. In the interim, position could be filled by Ruth Kelly - previously a junior minister at HMT and an economist by background.

Robert Barrie of Credit Suisse

It shouldn't really matter that much from a macro point of view. Moves to make the assessment of the public finances more independent might help make that more formal.

David Owen of Dresdner Kleinwort

No big insights, perhaps Alistair Darling. Does it make a difference with Gordon Brown next door, probably not. Why not have Ed Balls as Chancellor?

George Buckley of Deutsche Bank

At some point probably Ed Balls. But Mr Brown will still keep a close eye on No. 11 from next door, so the selection of Chancellor under a Brown premiership might not be as important in terms of his successor's ability to independently influence policy as in the past.

Neil Blake of Experian

Ed Balls; probably doesn't matter so much the next Chancellor will not have anything like the level of independence from the PM that the current one has

Jonathan Said of the Centre for Economics and business research

Ed Balls or Alistair Darling is likely to be. Not sure who should be. Yes it matters. The Treasury needs a Chancellor able to deal with tight public finances, and move to lower expenditure growth and tax rates.

Malcolm Barr of JP Morgan

Looks like Alistair Darling from what you guys tell me!

John Muellbauer of Oxford University

Ed Balls would offer maximum continuity.

David Frost of the British Chamber of Commerce

With Gordon Brown as Prime Minister the power base of the Treasury could diminish particularly if the rumours of radical changes to government departments materialise. Gordon Brown as Prime Minister would have a detailed understanding of how the Treasury works and this would inevitably lead to fundamental changes to the role of the new Chancellor whether the Treasury is split up or not. Alistair Darling is a strong candidate for the job but we think the days of a dominant powerful presence at Number 11 could be numbered under a Brown administration. For businesses what matters most is having a powerful voice at the heart of government making the business case and battling for curbs on public expenditure and perhaps for the first time a focus on the importance of getting value for money.

Jonathan Loynes of Capital Economics

It is unlikely to matter too much, since Gordon Brown is likely to keep a very tight control of economic and fiscal policy from no 10.

Stephen Lewis of Monument Securities

It is hard to say who will be the next Chancellor. It is equally difficult to believe that Gordon Brown will take no further interest in economic affairs once he becomes Prime Minister. Consequently, it probably does not matter much who becomes Chancellor.

Charles Goodhart, former MPC member

- (a) Darling
- (b) Darling
- (c) Not much

Willem Buiter, former MPC member and London School of Economics

Who knows? Who cares? As long as Brown is in number 10, the First Lord of the Treasury will Lord it over the Chancellor of the Exchequer.

John Butler of HSBC

Probably Ed Balls. If so, he is closely associated with the fiscal rules, like Mr Brown. So probably imply process of continuation rather than change.

Mark Cliffe of ING Bank

I've no inside track on this, but Alistair Darling and Ed Balls are favorites. It doesn't really matter, because Brown is still likely to be pulling the strings, and he has succeeded in converting fiscal policy into less of a macro-economic policy instrument than an exercise in micro-management. The fact that the media these days turns to accountants for comments on the Budget is symptomatic of this.

David Miles of Morgan Stanley

We do not expect any major changes in fiscal policy direction under a new Prime Minister/new Chancellor at this stage. Continuity seems the most likely outcome.

Will inflation fall away in 2007?

Question: Will inflation concerns disappear in 2007 as sharp rises in energy prices drop out of 12-month comparisons? Will the Bank of England's Monetary Policy Committee agree?

Will Inflation disappear?

Yes	13
No – underlying inflation is still rising as no spare capacity	11
Yes, but wages might be a problem	8
Yes, but not completely	7
No, but its not that serious	3
Maybe	1

Will BoE agree

No, BoE aware of underlying problems	14
YES (eventually)	9
If the data justifies it	2

Inflation is under control and will fall sharply in 2007 as energy price rises of last year [2006] drop out of the annual calculations, most economists believe.

Only 11 economists, one on four of those who expressed a view, thought that the rapid recent and prospective growth of the economy would ensure that inflation remains above the Bank of England's 2 per cent target and a worry into the new year.

The rest with varying degrees of confidence expected the rise in inflation in 2006 to drop away, particularly if the wage settlements in January proved benign.

There was less confidence, however, on whether the Bank of England would see it the same way. Many economists refused to predict what the Bank would do, but a clear majority of those who did thought that the Bank would remain concerned about underlying inflationary pressures for longer throughout 2007.

Even some of those who thought inflation was not a problem had little faith in the Monetary Policy Committee coming to the same conclusion.

Bridget Rosewell (Chairman of Volterra Consulting)

No and No. Though energy price rises drop out, the underlying rate of inflation is probably back up again as the potential to keep costs down by importing slowly fades. The Bank will be very aware of this, and cautious about the scope for growth in the real economy.

Philip Shaw – economist at Investec Securities

Yes, but let's keep an eye on wage data. Yes, the MPC will, eventually. We see an H2 rate cut (though partly as a result of lacklustre US growth).

Ian Plenderelith former MPC member

No. If the global economy continues to run fairly vigorously, as I expect, demand pressures will continue to need watching carefully for signs of inflationary pressure. I'm sure the Bank of England's MPC (and other monetary authorities) will remain very alive to the risk.

Michael Hughes of Baring Asset Management

Inflation concerns will not disappear but an easing of inflation will increase the probabilities of inflation targets not being exceeded in 2008 which will limit any further rises in rates. I do not expect rates to fall in 2007 however.

Howard Archer of Global Insight

Inflation concerns should certainly abate in 2007. Whether or not they disappear is likely to depend critically on whether or not wages move up significantly in the 2007 pay rounds.

Gerard Lyons of Standard Chartered Bank

One issue in 2007 may be whether inflation is measured properly! On the measures that the BOE looks at, inflation worries may subside, but not fully disappear. Central banks all claim that they are doing a good job, but perhaps that suggests they are being measured and assessed in the wrong way. Inflation is low in many countries, even in those without independent central banks. Yet asset price inflation is rife.

Ray Barrell of National Institute of Economic and Social Research

Inflation concerns will moderate but not disappear, with the recent rise in the exchange rate putting extra downward pressure on inflation in the short term. Interest rates still need to rise to ensure inflation pressures and expectations are reduced. I do not know whether MPC members would agree with me or with each others. However, I suspect Mervyn King would agree.

Ben Broadbent of Goldman Sachs

Yes. And it already does (though we would go further and have a central CPI projection that dips below target next August/September).

Keith Wade of Schroeders

Inflation concerns will never disappear, but the combination of lower oil prices and a weaker world economy should temper price pressures in 2007.

James Knightley of ING

I think they will disappear. Utilities are contributing 1.2 percentage points of the current 2.7% inflation rate, food is contributing another 0.6 percentage points so that leaves everything else contributing just 0.9% i.e.. An inflation rate of 1.1%YoY. Assuming utility bills do not change then that component will contribute just 0.5 percentage points by May, but with British Gas announcing cuts in its tariffs next year, it could fall even more quickly. Food should also correct as the unseasonable weather effects of 2006 fade. BoE is concerned about wages growth, which could push up inflation in other components, but with the labour market slackening (unemployment rate risen from 4.7 up to 5.5% of so as immigration pushes up labour supply) we don't see wage growth getting out of control.

John Calverley of American Express

Maybe. But it is a strange time in the world economic cycle to stop worrying about inflation. Output gaps are closed in most countries, unemployment is low, money/credit growth is strong and Chinese export prices are rising.

Peter Warburton of Economic Perspectives

I would expect that the UK CPI inflation rate will remain close to its average for 2006, but with a declining profile through the year. Food price inflation, I would expect to be in the region of 4%-5% and indirect taxes will contribute more to inflation than in 2006. MPC will remain concerned about the inflation outlook, although I cannot identify with their worries about tight capacity utilisation or concerns about an escalation of wage settlements.

Ian McCafferty of the CBI employers' organisation

On our projections, inflation is set to fall back to the 2% midpoint by late next year, and is likely to be in the 1-2% range by the spring of 2008. The critical uncertainty is whether 2007 wage settlements come in significantly higher than 2005 & 2006, signalling a rise in underlying inflation expectations and behaviour. Conversations with business suggest that while some settlements may be slightly higher than last year, the degree of competition and need for cost control will keep wage pressures under control. By the spring, inflation uncertainties should be easing, creating scope for a modest rate cut next autumn.

Paul Guest of Economy.com

Yes, I think they will and I also think the MPC will eventually come around to this conclusion. In fact, I think the risks for the inflation outlook are weighted much more to the downside and we could have a steep fall-off mid- to late next year as the energy/utility price upswing comes out of the equation, as does the increase in tuition fees. We tend to be closer to Blanchflower's assessment of spare capacity in the economy; namely, that there is not a lot but there is more than the baseline MPC forecast assumes.

Howard Davies former MPC member and director of the London School of Economics

Falling energy prices will reduce price pressure to some degree, but the bigger issue is the rate of capacity growth. I think inflationary pressures will not abate entirely if growth continues at the rate foreseen in the PBR.

Fionnula Earley of Nationwide Building Society

* Inflation concerns should moderate as energy prices fall out. Extent to which they will depends on state of consumer's demand and their willingness to accept wider margins.
* Much also depends on the pay round. If it passes without high settlements, the MPC are likely to be less concerned about inflation, especially if they believe there is now a higher trend rate of growth

Professor Mike Wickens of the University of York

Yes. There was no strong reason to raise rates in November. The reasons given were specious. The real aim was to send a signal designed to anchor inflation expectations. Otherwise a 25 basis point change has no predictable of significance. I have spoken to MPC members who concede the point.

Stephen King of HSBC

a. Yes
b. Will the MPC agree with my "a" or will they agree with each other? As the year progresses, inflation will remain well behaved. Second round effects will remain dormant, reflecting enhanced credibility and the effects of globalisation on wage-price setting. There's a good chance of a rate cut in the second half of 2007 otherwise inflation might undershoot target. The debate within the MPC will last quite a while for the simple reason that supply-side shocks are difficult to quantify but appear to be playing havoc with the Bank's economic models.

David B. Smith, University of Derby

I expect CPI inflation to ease to around 2% by the end of next year, and more or less hold that level through 2008. This allows for some easing of sterling, but not a major collapse. By the middle of next year the MPC's forecast horizon will extend through 2011, of course, and the energy-cost effect may have dropped out or reversed by then. The UK November data were poor by international standards, however, and may be 'a warning shot across the bows'.

Professor Patrick Minford of Cardiff Business School

Yes, and see above. The MPC is still confused by 'up-down' economics.

Diana Choyleva of Lombard Street Research

Inflation concerns are unlikely to disappear in the first half of 2007 as there is no slack in the UK economy and growth seems set to stay above-trend in coming quarters. But a weakening global economy should shift the balance of the risks by the end of next year.

Richard Jeffrey of Ingenious Media

While it is apparent that some of the rise in inflation has been caused by temporary factors (mainly energy and utility costs), it would also seem that there has been a rise in core inflation (and, anecdotally, many companies are reporting that they are experiencing greater pricing freedom). This highlights a long-term concern that I have had: that the UK's seeming success in controlling inflation has been exaggerated by influences from outside our borders (increasing low cost supply, etc.). What appears to be showing through now is that domestically generated inflation has, for a long period, been higher than the headline price-measures might have indicated.

I think that for some while some members of the MPC have shared this view. However, their

concerns have been negated by the argument that the 'absolute' of the inflation target is all that matters. I believe that inflation will remain above target over the coming year and that the MPC will remain relatively hawkish as a result. I would be surprised were interest rates not to rise again.

Ross Walker of Royal Bank of Scotland

UK inflation is set to fall sharply in spring 2007 thanks to favourable base effects (as huge energy price increases in April and May 2006 drop out) and this will provide some reassurance in the near term. However, uncertainty lingers over the consequences of the flood of liquidity unleashed in recent years which has thus far appeared primarily in asset price inflation rather than consumer price inflation. It is not our central scenario, but there is a risk that CPI inflation becomes rather sticky above its 2% target.

Graeme Leach of the Institute of Directors

Inflation concerns won't disappear in 2007 even as energy effects drop-out of the year-on-year index. Two key concerns remain: (1) The lack of spare capacity - the IoD's capacity utilisation index went from -15% to almost zero over the summer and autumn. (2) Strong money supply growth needs to slow sharply and doesn't appear to be doing so yet, despite tighter monetary policy.

Katherine Booker of Oxford Economics

Petrol prices have already come down and some utility companies are pledging to cut tariffs in the spring so it seems likely that the spike in inflation caused by energy prices will unwind quickly next year. But the MPC will remain concerned about inflationary wage settlements in the New Year and firms seeking to rebuild their profit margins.

Robert Barrie of Credit Suisse

Base effects from the energy component should be favourable and large next year and there could even be some energy price cuts to take headline inflation down further. On the other hand, CPI ex energy inflation has been rising in recent months and the components behind that rise - core goods and processed food - are both persistent and predictive. If that's right, inflation concerns may change, but won't disappear. In fact, the numbers will be harder to dismiss.

David Owen of Dresdner Kleinwort

Not entirely, particularly if economic growth remains robust (after all, the inflation target is set in reference to the medium term)

George Buckley of Deutsche Bank

There may be more focus on core measures of inflation in 2007 as headline rates are distorted heavily downwards (assuming no further sharp rises in oil prices) by petrol price basis effects. The Bank should to some extent try to look through these effects (another way this can be done is to look at the mom changes of a seasonally adjusted version of the CPI). But the BoE sets policy with the intention of influencing growth and inflation more than a year hence, so next year's developments may be less important than the MPC's medium term forecasts for inflation. Upside risks come from a topping out of import penetration from China (i.e. no longer widening the net of cheaper goods we import), a possible fall in sterling and stronger than expected global growth.

Diane Coyle of Enlightenment Economics

Yes if the oil price continues to behave. But it's the labour market, not energy, that's at the heart of the MPC's debates so I think they'll continue to disagree.

Paul Mortimer-Lee of BNP Paribas

We can think of inflation depending on two things – inflation expectations and output (or output growth) in relation to potential. Utility bills and other special factors such as drought are boosting inflation and therefore inflation expectations. These will not be repeated and so inflation will drop sharply next year, helping lower inflation expectations and drastically slashing risks of second round effects from wages. At the same time output seems set to grow below potential. Thus it is highly likely that the Bank of England will end next year with rates lower than they are now.

Neil Blake of Experian

Hopefully; eventually

Marian Bell, former MPC member

This seems most likely outcome. It is unlikely that supply is particularly stretched, though not a great deal of slack either other than in the labour market. But see risk at 1 ii) above. Will the Bank of England's Monetary Policy Committee agree? When they see the data.

Jonathan Said of the Centre for Economics and business research

Yes, yes

Malcolm Barr of JP Morgan

Disappear is too strong a term, but they are likely to abate. Rates are likely to stabilise as a result.

Milan Khatri of the Royal Institution of Chartered Surveyors

Inflation concerns are likely to remain high in 2007 as economy will benefit from stronger growth in euro area and a us economy which will see the end to the housing market slowdown. wage inflation is likely to gradually build due to firming labour market. it is no surprise that consumers see their financial position as robust which is paving the way for a spending rebound, underpinned by a robust housing market.

John Muellbauer of Oxford University

There are still some inflation risks, one of them being higher import prices, though Dollar weakness has helped that in the short-run. Besides, higher oil prices may well return. The MPC will, however, probably be even more concerned about asset prices and the future instability caused by a collapse from even higher levels.

Martin Weale, director of the National Institute of Economic and Social Research

With help from a further interest rate increase inflation is likely to fall back to target. But this does not mean that interest rates can subsequently be cut.

David Frost of the British Chamber of Commerce

Headline CPI inflation will increase temporarily in Q1. But UK inflation concerns will ease in 2007, if wage pressures, particularly in the public sector, are kept under control in the next wage round.

We are not sure the MPC will agree. We are concerned that they may wish to tighten policy too aggressively, and this could worsen the slowdown in the pace of growth.

Charles Goodhart, former MPC member

(a) No

(b) No

NB – The monetary data have been telling us that for some time now.

Jonathan Loynes of Capital Economics

Yes, inflation concerns should largely disappear this year as fading energy effects and subdued core price pressures allow the headline rate to drop back below its target in the second half of the year. The MPC will remain wary of lingering inflation dangers in the first half of the year, but should become more relaxed in the second,

Stephen Lewis of Monument Securities

Inflation concerns are likely to persist reflecting anxiety over the trend in labour costs. The MPC is not expected to let down its guard.

Willem Buiter, former MPC member and London School of Economics

No. Inflation concerns will remain. The MPC will probably have to raise rates further and will do so.

John Butler of HSBC

The key test is the first 4 months of the year - will pay settlements pick up. I think the rise in the pool of available workers - through migration and also rise in participation rate - should keep a lid on nominal wage growth. If so, then I would be unconcerned about inflation in 2007 and 2008. I would be more concerned about where will the growth come from in 2007. As the government boost ends, private sector growth may struggle to fill the void left. Slower global growth should hamper exports. Lower profit growth should limit the recovery in investment. While, the debt burden, squeeze in real income and rise in savings should cool consumer spending.

A slowdown in demand and high level of sterling should keep inflation subdued. So as energy/food impact diminishes, so should headline inflation.

Eventually the BoE will agree. But central banks are different when their starting point is one in which inflation is above rather than below target. When inflation below, they can be preemptive and err on the side of supporting growth. When inflation above, they will need to be more convinced pressures are cooling. So MPC will be more reactive going forward.

Alan Budd, former MPC member and Queen's College, Oxford

If there are no more price shocks, inflation concerns will probably decline by the end of the year though they may rise earlier in the year. The MPC will agree if the data justify it.

Mark Cliffe of ING Bank

Yes, but the MPC may be slow to concede this. The MPC has been consistently overly cautious on inflation, and is probably still underestimating the disinflationary benefits of globalisation, technical change and immigration.

David Miles of Morgan Stanley

Our central case is that inflation declines back towards target, however with risks of wages becoming more inflationary around the turn of the year, risks to this profile are probably to the upside.

Amit Kara of UBS

Yes, inflation will likely be below the mpc's target by end-2007 not only because the sharp rises in energy prices in 2006 drop out of the comparison, but also because gas prices will likely fall following the recent falls in wholesale prices (I am assuming this story has not changed significantly while I have been on holiday!).

Are global imbalances still a problem?

How likely is it that the US current account deficit will decline as a share of US GDP in 2007?
With the dollar declining gradually, is this time to stop worrying about US current account?

Will the US current account decline as a share of national income?

CA will decline	21
CA will stay the same or grow	10

Should we stop worrying about it?

Stop worrying	13
Worry	16

The world economy is destined to witness the first significant decline in the US current account deficit since the early 1990s as a share of gross domestic product, according to the FT panel of economists.

The reasons are related to lower oil prices limiting the cost of US imports, a US slowdown reducing the quantity of imports and the past four years decline in the dollar having a slow positive effect on the US trade position.

Two thirds of the economists polled thought the US current account deficit would decline substantially in 2007, but many of those thought the deficit was still so large that it remains a serious risk for the global economy.

A majority of economists still think the world should worry about the implications of a sudden adjustment of the deficit rather than a gradual decline over many years with US demand taken up elsewhere in the world.

The potential problems include a dollar crash, higher global interest rates, a US slowdown and disruption to the world's trading systems.

Bridget Rosewell (Chairman of Volterra Consulting)

It is still a huge sum of money - requiring large inflows of capital, even if it shrinks. So now is precisely not the time to stop worrying.

Philip Shaw – economist at Investec Securities

Unlikely. Lower energy prices will help but not sufficiently. Import values are 40% greater than exports at present, so on a purely arithmetic basis, export growth has to be 40% greater than import growth for the deficit to stay still, which looks unlikely in the absence of a very sharp slowdown

Ian Plenderelith former MPC member

Not much, but hopefully less single-minded focus on that statistic and more willingness to look at trends in the global economy as a whole.

Michael Hughes of Baring Asset Management

I would expect the current account to stabilise as a percent of US GDP given higher domestic demand growth rates in the rest of the world. I doubt however that the weakness of the dollar against emerging market currencies is yet over. I doubt also that the dollar will weaken much further against the euro. Capital flows continue to dwarf trade finance so the current account is less important than it was.

Howard Archer of Global Insight

The threat of the U.S. current account deficit is receding gradually. The ratio of the deficit to U.S. GDP is expected to fall from its current high of 6.8% to around 5.8% by the end of 2007. Meanwhile, the dollar is expected to keep falling gradually over the next couple of years, which should allow businesses in the U.K. and other parts of the world to make the necessary adjustments

Gerard Lyons of Standard Chartered Bank

No. But I think any such worries should be put in the context of the global economy and the need for more balanced growth.

Ray Barrell of National Institute of Economic and Social Research

A sharp fall in the dollar normally involves an improvement in the current account after a year or so (the J curve is short lived), so we could see a further worsening before the current account improves. Absorption in the US needs to decline markedly to improve the current account, and this could only happen with either a change in national savings for autonomous reasons or a risk premium induced devaluation that was accompanied by a risk premium induced fall in investment.

Ben Broadbent of Goldman Sachs

Probably will decline but still too high and still a worry.

Keith Wade of Schroeders

It is highly likely that we see a decline in the US current account in 2007, but this will be due to weaker US demand and slower import growth rather than the competitive benefits of dollar devaluation. The deficit will remain high in absolute terms and will deteriorate again as the US recovers. Global imbalances have been officially downplayed recently - perhaps it is time to start worrying.

James Knightley of ING

With the dollar declining gradually, is this the time to stop worrying about US current account? Yes though we don't expect too much change in the deficit, though it probably has toughed.

John Calverley of American Express

The CA deficit may fall slightly in 2007 because of the slowdown in the US economy. But it will stay relatively large. I am not particularly worried, however. It can be easily financed.

Peter Warburton of Economic Perspectives

It is very likely that the US current account deficit will decline as a share of GDP in 2007 as US consumption decelerates and business inventories and investment adjust to a slower pace of economic growth. The conditions upon which this deficit has been readily financed by capital flows are subject to more violent change however. Expect vast inflows into US agency, corporate and securitised debt to abate in 2007, leaving deficit to be financed by money flows and Treasuries, implying higher US bond yields. The disturbances to financing flows are likely to overwhelm any reduction in the current account deficit.

Ian McCafferty of the CBI employers' organisation

The deficit is likely to decline from the 6½% of GDP, in response to lower oil prices, but the underlying problems that it poses will not go away. Even at 5% of GDP, the deficit requires the US to import \$12bn in portfolio capital a week to offset the dollar outflow implied by the deficit. A gradual decline in the dollar is unlikely to make sufficient inroads into the deficit without policy change both within the US and elsewhere. The imbalances remain a significant risk to global economic stability.

Howard Davies former MPC member and director of the London School of Economics

There are welcome signs of a correction beginning. But it is too soon to stop worrying. There is a long way to go.

Professor Mike Wickens of the University of York

The US dollar: The biggest risk is the US dollar and its effect of UK and EU competitiveness in the short run. This may cause quite a lot of uncertainty. In the longer run the US economy should be stronger as a result of a weaker dollar. This should generate higher US economic activity and give a boost to exporters.

Stephen King of HSBC

a. Only if Europe and Japan keep growing, and I doubt this will happen. However, I'm not sure the current account deficit is quite so worrying economically as is traditionally claimed. Fast-growing emerging markets with poor domestic capital allocation skills can't help but generate savings surpluses and, thus, the rest of the world can't help but generate a savings deficit. The key political issue is one of ownership: the more assets acquired by emerging markets, the greater their ability to buy controlling stakes in hitherto-western-managed companies. I'm not convinced that either Congress or the EU are prepared to accept this implication, pointing to a world of growing capital market protectionism.

David B. Smith, University of Derby

In an open economy, current account deficits are a prima face indicator that monetary policy is too lax (this applies to the UK also). As a result, I would regard the US deficit as indicating that Greenspan got it wrong. The US current deficit should ease, but is unlikely to cause a run on the dollar, in any case, if Bernanke acts as he should.

Professor Patrick Minford Cardiff Business School

It must be remembered that US net foreign debt has not risen much over a long period, reflecting the high demand for nominal dollar assets (mainly for the reserves of eastern central banks). Thus the deficit has been little problem from the US viewpoint. At some point eastern emerging market

countries will take a tougher line on the dollar; but as far ahead as I can see their attitude will continue to be that the US market is too important to them to allow the dollar to depreciate much against their currencies. As US growth is now slower and the dollar at historically low levels, I expect the deficit to fall a bit and the pressure to come off the dollar.

Diana Choyleva of Lombard Street Research

The correction of the global imbalances is likely to start with the exhaustion of America's desire to borrow, not with the fall in the Eurasian desire to save. As a result, the US current account deficit will improve because of a collapse in domestic demand. This argues for a strong dollar as the supply of dollars slows while dollar demand stays strong.

Richard Jeffrey of Ingenious Media

It seems unlikely that the US current account deficit will decline substantially as a proportion of GDP. While weaker growth in domestic demand may help in the first half of 2007, there will also be a negative 'J' curve effect from the fall in the dollar. In the second half, domestic demand is expected to gain momentum - to the detriment of the trade accounts.

Graeme Leach of the Institute of Directors

The US current account deficit is likely to decline due to the shift in relative growth and dollar devaluation. However, I still think it will be 'sticky' on the large side. Deeper decline in the dollar seems inevitable in the future. This story is not over.

Katherine Booker of Oxford Economics

An improvement in the CA deficit is virtually assured in Q4 this year due to the drop in oil prices. With the decline in the dollar and healthy economies abroad, real exports should continue to outpace real imports, so it is more likely than not that the deficit will fall as a share of GDP in 2007. But we shouldn't stop worrying altogether, as it is possible to imagine circumstances under which oil prices could soar again or the dollar could decline more sharply.

Robert Barrie of Credit Suisse

We expect the deficit to fall slightly in the coming year, though it may not do so by much over such a short period. It's not clear how much that matters - the latest round of dollar weakness has been associated with the idea that the US economy is slowing and that the European economy is not. To that extent, it's more cyclical than structural, though if it lasts for long enough, balanced growth in the global economy, with the US following rather than leading, could make for a much narrower deficit over a longer period of time.

David Owen of Dresdner Kleinwort

Very likely the US current account deficit declines. Is it a problem, yes, because of the potential implications for sterling and hence UK exports etc if we saw a more disorderly move in the dollar to correct international imbalances. Foreign exchange markets very fickle. History shows that for much of the time currencies broadly trend sideways, before there is a sharp movement one way or the other.

George Buckley of Deutsche Bank

The US current a/c deficit continues to grow, and as a result one of our risk scenarios is a dollar collapse, particularly with global investors reassessing the attractiveness of dollar denominated assets. Any widespread diversification away from dollars by the international investor community could precipitate a more unruly dollar correction. This in turn could push US interest rates up. Our central view is for the deficit to improve modestly in 2007 and stabilise in 2008. We see USD weakening over the next 3m against EUR then stabilising in 07 and 08.

Paul Mortimer-Lee of BNP Paribas

The US trade balance is the result of millions of decisions by US and foreign entities on production, consumption, investment and borrowing. The fact that the deficit has remained high without severe adverse pressures on US asset prices (no USD collapse, not panic widening of spreads or downward pressures on stock prices) shows it is not something we should worry about unduly in the short run, even though in the long run it does not look sustainable.

Depending on how those decisions evolve, the trade deficit may rise fall or stay the same. It would be no surprise if, given slowing US growth, US households and corporates decided to bring spending more into line with income, narrowing the deficit somewhat. However, since US imports of goods are 174% the size of exports of goods a sharp slowdown in US spending (i.e. a recession) would be needed to make a significant impact on the deficit.

Neil Blake of Experian

Should decline a bit; the US CA itself isn't a problem but the flip side, high personal & government debt, is

Jonathan Said of the Centre for Economics and business research

With the dollar declining gradually, is this the time to stop worrying about US current account? It will probably stabilise but not decline sharply. It will decline very gradually over time as China and India develop and their costs of production rise.

Malcolm Barr of JP Morgan

Any decline in the current account deficit is likely to be small, and we should still worry about it, recognising that worry has been with us for a while.

John Muellbauer of Oxford University

The US is rebalancing economic activity, with the famed 'soft landing' looking to be on track. Asian growth is becoming more self-sustaining and hopefully will allow Chinese policy makers to take a more rational view about the long-term economic interests of their population. It doesn't make sense to choose terms of trade which 'give away' exports at such low prices and pay so much for imported resources: this sacrifices Chinese living standards to the benefit of American ones. At higher values of the Renmimbi, the Chinese would be better off, with not such a large sacrifice of the growth rate of production.

Martin Weale, director of the National Institute of Economic and Social Research

The US current account is not a worry per se but a sign of an economy with very low saving. I think the dollar fall is likely to lead to increased saving. I am not sure how large the US savings gap is; its savings needs are lower than in Europe because people retire later.

David Frost of the British Chamber of Commerce

Our forecasts suggest that the US current account deficit will decline in 2007 as a share of US GDP. But the US deficit will remain massive, and will still worsen the risk of currency instability in 2007. It is too early to stop worrying about US current account.

Charles Goodhart, former MPC member

- (a) Stabilisation is the best that we can expect
- (b) No

Jonathan Loynes of Capital Economics

The US current account deficit will almost certainly fall as a share of GDP in 2007, due to a combination of lower oil prices, weaker economic growth in the US and the boost to net trade from a weaker dollar. Indeed, the deficit has already fallen from a peak of 7.0% of GDP in 2005 Q4 to 6.8% in 2006 Q3. However, it still has a long way to go before it gets down to a sustainable level, which is

probably around 3% of GDP. The current account deficit is also the symptom of wider problems, notably the unsustainably low household savings rate in the US. In the meantime, fading support from growth and interest rate differentials will continue to undermine the dollar.

Stephen Lewis of Monument Securities

There is a better than evens chance that the US current account deficit will decline in 2007. But if it does fall, it will probably not be by very much, seeing that the investment income balance is turning against the USA as a reflection of the rising US foreign debt. Worry relates to the financing of the deficit rather than to the deficit itself. Financing could become more difficult, even if the deficit shrinks, should Asian central banks abandon their interventionist foreign exchange policies.

Willem Buiter, former MPC member and London School of Economics

Stop worrying.

John Butler of HSBC

Should decline gradually. Will be resolved more rapidly if other parts of the world are growing faster than the US. However, despite some rotation of growth, most areas around the world still lack a genuine or rapid consumer recovery and hence self-sustaining growth.

Alan Budd, former MPC member and Queen's College, Oxford

If the US economy slows down relative to the rest of the world, the balance of payments deficit is likely to fall as a share of US GDP. People should continue to worry as much as they should now; i.e. not very much.

Mark Cliffe of ING Bank

There's a reasonable chance that it will fall, but it is not the size of the deficit that we have to worry about, but rather the willingness of foreigners to finance it. That willingness depends far more on how attractive US assets are, not on whether the deficit is \$600, 700, 800 or 900bn. If the US economy tanks, that's when the dollar will be in big trouble.

David Miles of Morgan Stanley

The pace of demand growth in the US has already slowed considerably and the exchange rate is down sharply - so it would be surprising if the deficit did not fall as a per-cent of GDP.

Your favourite policy change

If you could change one aspect of UK economic policy, what would that be and why?

Change fiscal rules	8
Public spending restraint	7
Simpler taxation	5
Change MPC remit	3
Less regulation	3
Abolish tax credits	2
Better MPC appointments	1
Abolish RDAs etc	1
World economic policies	1
User charges in public services	1
Lower corporation tax	1
Higher taxes and income tax	1
Build houses	1
Measure public output better	1
Global warming action	1
No Shared equity schemes	1
More weight on wealth creators	1
Local choice in social services	1
Tax savings less	1
Stop talking about international competitiveness	1
Road Pricing	1

When asked what policy economists would most like to change, only six ideas got more than one vote.

The most popular with eight was a change to Gordon Brown's fiscal rules, with most wanting to make their assessment more independent of government and some wanting a fundamental redesign.

In second place was greater public expenditure restraint, which scored highly among those who worry that Britain's long-term competitive position has been damaged by the surge in public expenditure since 2000.

Third was simpler taxation, which was popular among those horrified by the increased complexity of the tax regime under the present government.

Fourth and fifth, each with three votes were less regulation and a change to the Monetary Policy Committee's remit with a desire to give the Bank of England more control over monetary policy

Finally in sixth place was an abolition of tax credits, which were seen by two economists as a complicated way of damaging work incentives.

Bridget Rosewell (Chairman of Volterra Consulting)

Abolish all industrial and regional economic policy bodies. In this way, the DTI, RDA and regional Government offices could be closed down and posts abolished.

Philip Shaw – economist at Investec Securities

More restraint on public spending. Not sure where, exactly, but that's my gut feel

Ian Plenderelith former MPC member

Not for the UK, but for the world as a whole, I would hope for greater willingness by major countries to shape their economic policies in the light of a shared view of what is best for the world economy as a whole. I don't mean this to sound idealistic, but there have been times in the past when this has been achieved and we have not always matched our predecessors' internationalism in recent years - Doha a case in point, but limited international co-operation in addressing global imbalances is another.

Michael Hughes of Baring Asset Management

One aspect of UK economic policy I would change is the forecasting horizon for inflation targeting. Two years is too short a period to control inflation and risks greater interest rate volatility at a time when debt may be more important than inflation as a threat to economic stability.

Howard Archer of Global Insight

I said it last year, I am saying it again this year, and I suspect I could well say it again next year. I would change the "Golden Rule" as the regular adjustments to the timing of the economic cycle are becoming a farce.

At the very least I would like to see an independent body given full responsibility for determining the start and end of each cycle

Gerard Lyons of Standard Chartered Bank

A fundamental reassessment of how we pay for public services. In recent years, many public services have been better funded, without any noticeable improvement in output or productivity. Once there is a disconnect between the payer and the recipient of a service there appears to be no guarantee of the quality of that service. Ensuring that the consumer has choice and pays would address this, with immediate reimbursement for those who qualify for free services or relief. The problem is clear, a solution needs to be found.

Ray Barrell of National Institute of Economic and Social Research

External, non-professional appointment to an MPC that publishes votes is rather more unusual than UK commentators realise. A move to a more professional group of economists/central bankers with target independence would be wise.

Ben Broadbent of Goldman Sachs

I would sharply reduce the rate of corporation tax (in line with the trend in almost every other country) and, in a revenue-offsetting way, reduce the scope for deducting interest from that tax liability. As an adjunct, I would do anything I could to undo all the complications Brown has introduced into the tax system

Keith Wade of Schroeders

That there is an independent authority monitoring fiscal policy in the UK. If only to stop the Chancellor from re-defining the cycle to meet the golden rule every year! More seriously, the UK would benefit from a more formal structure where we have an independent judgement on the sustainability of fiscal policy over a time horizon longer than that of a politicians.

James Knightley of ING

The usual stuff about increasing simplicity of the system and maybe lower corporation tax for small businesses as a way of encouraging entrepreneurship.

John Calverley of American Express

I would seek to reverse the creeping tax-and-spend direction of the current government.

Peter Warburton of Economic Perspectives

Phase out working tax credits and pension credits. Destructive to economic incentives, poorly targeted, deeply resented, widely abused, costly and difficult to administer, a disaster from start to finish.

Ian McCafferty of the CBI employers' organisation

While macro-economic policy has delivered stability, there has been instability in other areas – notably the tax regime – due to too much micro-management. We need to ensure that the tax system is stable and predictable as well as supportive of international competitiveness. This may be helped by an end to the primacy of Budget secrecy, which would allow much greater consultation and debate about taxation policies. This would, I hope, reduce the degree of unintended consequences the ensue from changes in legislation, as well as the subsequent reversals of policy that have become more common in recent years.

Paul Guest of Economy.com

I would reduce the amount of government oversight and bureaucracy, both in terms of regulation from Brussels and Westminster. Despite numerous promises to reduce "red tape", very little has been accomplished.

Howard Davies former MPC member and director of the London School of Economics

i think taxes ought to be a little higher, and i regret the fact that the government now never seems prepared to envisage the simplest and fairest means of raising revenue, which is a rise in the basic and upper rates of income tax. It is unfortunate that these simple changes have become politically out of bounds, leading to ever more complex methods of skinning the fiscal cat.

Fionnula Earley of Nationwide Building Society

For the housing market the most important issue is sorting out housing supply. Even with the Barker Review it seems this will take some considerable time to resolve

Professor Mike Wickens of the University of York

Role back the state, which has grown in all aspects under Labour, especially in red tape and the share of GDP taken.

Stephen King of HSBC

Better measurement of public sector output, as mentioned above.

David B. Smith, University of Derby

Public spending is too high, the tax and benefits system are needlessly complex and provide perverse incentives, and regulation is a massive disincentive, especially to the small business sector. With international competition hotting up, this looks like a recipe for rapid relative economic decline. The restoration of a more liberal-market approach to economic policy making and a switch to pro-growth 'Irish' style policies rather than old school 're-distributionist' policies would top my wish list. However, there appears to be no prospect of this happening and no politician brave enough to even raise the issue.

Professor Patrick Minford Cardiff Business School

See above my comments on Brown's tenure. The share of public spending in GDP has gone up to around German ratios which in turn are too high and (rightly) falling. In Brown's term of office all the good work of the previous Conservative governments in limiting taxation and spending has been thrown away. The results in terms of public service performance have been bad with productivity falling sharply; Brown and Blair have vacillated on the issue of internal public sector markets, starting by abandoning what they inherited and latterly reverting to them. The vacillation has, like the massive run-up in spend, hurt service performance. Thus I would cut back spending, reinforce the internal market, and reform taxation to make the UK a first class business environment.

Diana Choyleva of Lombard Street Research

The Bank of England has done a sterling job so far, but the real test is yet to come. I would change Gordon Brown's micro-fiddling.

Richard Jeffrey of Ingenious Media

I would be in favour of giving the MPC more policy scope. While a single-point inflation objective may have been useful in helping the MPC gain credibility, it is also a very naïve approach to policy. First, it takes no account of the causes of high or low inflation (as argued above, domestically-generated inflation has probably been above target for some time; indeed, an inflexible inflation target probably meant that the UK wasted some of the benefit of falling international prices and that for a time, the MPC was targeting a rate that was too high). Second, there is a presupposition that if inflation is on target that all is well in the economics world.

There have been periods in the last ten years in which the MPC has been forced to take perverse interest rate decisions. For instance, rates have been cut when unemployment has been declining, domestic demand growth has been above trend, money demand has been rising substantially and house price inflation has been escalating. The result has been the emergence of substantial and still growing trade and current account deficits. The UK may have enjoyed low-inflation growth, but it has not been balanced growth.

This approach to policy is driven by the mathematical observation that if you have one equation you can solve for only one variable. However, our policy makers should be able to be more sophisticated in their approach. There are times when inflation should be the primary target. However, there are other occasions on which the pursuit of a fixed and arbitrary target will be to the medium term detriment of the economy.

The problem lies in the original 1997 remit that stated " The Bank's task can be interpreted as achieving the highest level of economic growth consistent with keeping inflation at 2 1/2 per cent". This has been taken too literally by many members of the committee (e.g. DeAnne Julius), hence the unbalanced growth that has been achieved and the sacrifice of competitiveness.

So, I would like to see the MPC given a broader remit that has a balanced growth objective introduced as a more obvious, if subsidiary, policy constraint.

Ross Walker of Royal Bank of Scotland

The tenth anniversary of BoE independence in summer 2007 would be an appropriate time to acknowledge that wider monetary and macroeconomic stability does not begin and end with 2% CPI inflation. This is not to advocate formal asset price targeting (I believe this would be a mistake), but merely to allow policymakers more formal discretion in setting monetary policy. The MPC has cut its teeth. It seems preferable that the MPC is permitted to tighten monetary policy in response to, say, very strong credit growth on its own merits, rather than having to justify this in terms of its expected effect on CPI inflation in two years' time (which risks having a rather contrived, artificial feel about it).

Graeme Leach of the Institute of Directors

Free the people ... there are no significant economic and social gains from having the state above one-third of GDP in an advanced economy such as the UK.

Katherine Booker of Oxford Economics

The drive to raise homeownership through shared equity schemes. This is a market intervention that could have quite unanticipated and serious consequences if house prices do anything other than keep rising at a fairly steady rate. Just need to think about endowment policies following the bursting of the dot com bubble. Increasing the exposure of lower income households to volatile asset prices massively increases the risks they face, and adding to housing demand hardly solves issues of affordability. If the problem is retaining public sector staff in high house price areas, then shouldn't the government be looking to pay more competitive salaries, or investing in new, innovative ways to increase housing supply instead?

Robert Barrie of Credit Suisse

Independent assessment of the fiscal position - the current arrangements are the last remaining reminder of the bad old days.

David Owen of Dresdner Kleinwort

Stop all the micro management and government induced targets for everything, which create all these perverse incentives! Make John Kay compulsory reading at the Treasury.

George Buckley of Deutsche Bank

Fiscal policy needs a fresh focus - the rules are almost meaningless given the variable length of the cycle. Also, there has been some discussion of the need to provide a longer term focus for monetary policy (as opposed to the current month by month modus operandi).

Neil Blake of Experian

simplify and extend the WFTC system; phase out means testing for pensions much quicker than planned

Jonathan Said of the Centre for Economics and business research

Fiscal Policy. The rise in fiscal revenue and government spending is making the UK less competitive in the international economy. More than a half of jobs growth in the last 10 years was in the public sector, which is part of the reason why productivity levels have declined. UK plc continues to under invest in its capital stock.

Malcolm Barr of JP Morgan

Give the MPC responsibility for dating the economy cycle and generating the growth forecasts used for fiscal purposes, then create a committee (separate from the MPC) to oversee the fiscal rules. Would force the MPC to be more transparent about their forecast, and give them something to do at the monthly meeting Lomax thinks they don't need, not to mention making the fiscal rules bite.

John Muellbauer of Oxford University

The most fundamental problem we all face is that of global warming. UK policy on a broad front from regulation to taxation should do more to tackle this, while continuing to press for international agreements on action. The demonstration effect from domestic action and the commercial competitive advantages to early movers should not be undervalued.

That said, property tax reform should be high on the agenda. Most advanced countries levy some form of annual residential property tax linked to the value of the property. Britain is the only country in the world where those living in £20m houses pay the same as those in £1m houses. This unfairness to the middle classes makes no sense when there seems to be almost limitless demand

for 'trophy homes' at the top end of the UK market. Further, regular revaluations for property tax are a long overdue reform.

Milan Khatri of the Royal Institution of Chartered Surveyors

government needs to review sustainable debt rule of 40% which makes little sense and is quite arbitrary. there is a danger that this rule could prove a barrier to raising investment in transport and built environment infrastructure in the next decade which are key areas in supporting rising living standards and economic activity.

Martin Weale, director of the National Institute of Economic and Social Research

I would set the budget with reference to the overall savings needs of the country. There are two macro-economic decisions people make- the work/leisure choice and the consumption/saving choice. It is extraordinary that the government has neither a policy nor an aim for the latter.

David Frost of the British Chamber of Commerce

The most important aspect that I would change is increasing the weight given to the needs and interests of wealth creating businesses in the overall formulation of UK economic policy

Charles Goodhart, former MPC member

Get more local choice and better incentives to perform well into Social Services. Improve public transport. In last 30 years work at home has been much improved, work at place of work made better, but commuting between home and work has worsened dramatically.

Jonathan Loynes of Capital Economics

An independent judgement of the economic cycle would help to increase the credibility of the Chancellor's fiscal rules.

Stephen Lewis of Monument Securities

The most important change for the future would be to shift the balance of taxation away from saving and towards expenditure. Such a move would encourage saving and help ward off the threat of economic dislocation and social breakdown that looms as a result of currently insufficient provision for future pensions.

Willem Buiter, former MPC member and London School of Economics

Massively simplify the tax and benefit system, preferably moving to a negative income tax. In the best of all possible worlds, the base for the income tax would be consumption. Does negative consumption tax sound weird?

Alan Budd, former MPC member and Queen's College, Oxford

That policy-makers stop talking about something called "international competitiveness" or the "competitive challenge".

Mark Cliffe of ING Bank

Most economists would agree that the sharp increase in the complexity of the tax system and regulatory environment has been bad news for the supply-side of the economy. Sharply increased energy and environmental taxation would give a revenue yield that would allow other taxes to be restructured, simplified and cut.

David Miles of Morgan Stanley

Bring in regionally differentiated road pricing as soon as possible.