

The Bank of England's forecasts are wrong by design

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The [Guardian has noted that](#):

The Bank of England's chief economist has admitted his profession is in crisis having failed to foresee the 2008 financial crash and having misjudged the impact of the [Brexit](#) vote.

Andrew Haldane, said it was “a fair cop” referring to a series of forecasting errors before and after the financial crash which had brought the profession’s reputation into question.

Blaming the failure of economic models to cope with “irrational behaviour” in the modern era, the economist said the profession needed to adapt to regain the trust of the public and politicians.

The problem for Haldane is that the problem is systemic. A few exceptions apart (the E3ME model of Cambridge Econometrics, where I am a director, being an example) most macroeconomic modelling is done on the basis of general equilibrium analysis. This assumes that perfect competition prevails; the people are rational; and that markets adapt (or ‘clear’) perfectly to changes in economic stimuli. They also fail to treat money appropriately. The result is that of course the models fail to predict real world irrational behaviour. That is precisely because they are programmed not to do so, since those using them assume it does not exist.

Haldane could overcome his problems. He could use models that do not use the assumptions inherent in general equilibrium analysis. The E3ME model of Cambridge Econometrics, of which I am a director, does not do so, for example. It does not require rational behaviour. It does not require that markets clear. Sub-optimal outcomes can be predicted because they happen in the real world. And modern monetary theory can be built in.

That is the answer to Haldane's problem. He and the Bank of England have to look out

of their windows (of which there are few in the Bank) and realise that the world is not the one they're modelling. Then their forecasts might be relevant. Right now they are forecasting for a world that does not and never will exist. Of course they get things wrong. But that's wholly their own fault.