

Funding the Future

The Bank of England's forecasts continue to look hopele...

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I am struggling with this morning's [Bank of England \(BoE\) Monetary Policy Committee \(MPC\) report](#). There are a number of reasons.

One is that I find it intensely annoying when a report presents all its key findings in percentage terms. How is someone meant to know what 7.5% unemployment means when nowhere is data provided to give it a meaning? Economists who resort to such reporting are, in my opinion, always trying to hide something.

And then there is this table of assumptions, few of such strike me as plausible:

Table 1.C Indicative projections consistent with the MPC's forecast^{(a)(b)}

	Averages		Projections			
	1998–2007	2010–18	2019	2020	2021	2022
World GDP (UK-weighted) ^(c)	3	2½	1½	-6½	6	4½
World GDP (PPP-weighted) ^(d)	4	3½	3	-5	7½	5
Euro-area GDP ^(e)	2½	1½	1½	-8	6½	4
US GDP ^(f)	3	2½	2 ¼	-5½	5½	4½
Emerging market GDP (PPP-weighted) ^(g) of which China GDP ^(h)	5½	5½	3½	-4½	8½	5½
	10	7 ½	6	7 ½	8½	5½
UK GDP ⁽ⁱ⁾	3	2	1½	-9 ½	9	3 ½
Household consumption ^(j)	3½	2	1	-9½	8	3
Business investment ^(k)	3	3½	¼	-19	10½	9½
Housing investment ^(l)	3½	2½	0	-21½	26½	11½
Exports ^(m)	4½	3½	5	-10½	4½	½
Imports ⁽ⁿ⁾	5½	3½	4½	-11½	7½	1½
Contribution of net trade to GDP ^(o)	-½	-½	0	½	-1	-½
Real post-tax labour income ^(p)	3½	1½	1 ½	3	-4½	4
Household saving ratio ^(q)	8½	8½	5½	14½	7½	8½
Credit spreads ^(r)	¼	2½	1½	2½	2	2
Excess supply/Excess demand ^(s)	0	-1½	-½	-2½	-½	+½
Hourly labour productivity ^(t)	2½	½	0	-½	½	½
Employment ^(u)	1	1½	1	-3½	2½	2
Average weekly hours worked ^(v)	32½	32	32	31½	32	32
Unemployment rate ^(w)	5½	6½	3½	7½	6	4½
Participation rate ^(x)	63	63½	64	63½	64	64
CPI inflation ^(y)	1½	2½	1½	½	1½	2
UK import prices ^(z)	0	1½	-½	-½	½	½
Energy prices — direct contribution to CPI inflation ^(aa)	½	½	0	-½	0	0
Average weekly earnings ^(ab)	4½	2	2½	-1½	3	3½
Unit labour costs ^(ac)	3	1½	3	1½	-½	3½
Private sector regular pay based unit wage costs ^(ad)	1½	1½	3½	4½	-½	3½

Click the image for a larger version or go to the original report (sorry).

The essence of the MPC's assumptions is;

- * UK GDP will recover quickly, and quite strongly in 2022;
- * So too will consumption;

- * And in 2021 and 2022 business will invest heavily, and at much above normal rates;
- * This will be despite heavy falls in post-tax wage income in 2021 which will recover, in part in 2022;
- * Unemployment will rise this year, but be back to historically low rates by 2022 and participation rate in the economy will, if anything grow, meaning there will be a real rate of job growth over the next two years;
- * There will be labour shortages, or an excess demand for labour by 2022;
- * This will fuel above-average wage income growth.

Let me be honest: I am sure that this land of milk and honey must exist somewhere. But it is not a description of what I think likely to happen in the UK in the next two years or so. And the reasons are very easy to find.

First, the MPC assumes that Covid 19 is under control. Oh, happy days! If only that was true, of course.

Second, and as significantly, it would seem that the MPC thinks that credit is flowing easily to small businesses, and that the risk of corporate failure is low as a result. It would also seem that they think the current credit arrangements for small business will last forever. But that is not true. As [I noted very recently](#), on 30 July the FT reported that:

[T]he OBR assumes that up to 40 per cent of bounce back loans could default. Banking executives warn that the loss rates could be even higher. Thousands of companies face being pursued by their lenders for debts they cannot afford to repay.

And as I noted in response, the companies that this implies might fail might employ between them 6 million people in all, because smaller companies employ disproportionately large numbers of people on lower than average wages with lower than average productivity. As I said at the time:

Not all [those jobs] will be lost, thankfully. I am hopeful that will not be the case. But to pretend that many hundreds of thousands of small employers will fail and somehow the jobless total will hardly increase at all - which is the view presented by this FT article - is absurd.

In effect the MPC is now making the same claim on unemployment as the FT article. The FT said that despite all the evidence it found on the stress within the economy only 3 million people might become unemployed. The MPC 7.5% unemployment rate implies a figure of around 2.7 million as I extrapolate it. And both suggestions are, unfortunately, unsupported by the evidence.

Businesses that fail create unemployed people.

And they are not replaced immediately.

And I should add that the figures noted do not include those becoming unemployed who were previously self-employed.

The BoE has focussed its work on the wrong issues and has ignored an issue about which most of its members will, I suspect, have very little awareness, which is small business cash flow, which is what will kill the companies that will fail over the coming months and year. The consequence is a forecast that strikes me as utterly implausible in economic terms, and that's before we even take into account the suppressed 'animal spirits'. The BoE found evidence of such suppressed spirits, for example in investment plans, and yet assume that investment will happen anyway.

So why does this mistaken forecasting happen?

One reason is the lack of experience of the real world in places like the BoE.

The second is, of course, political control: the Bank is delivering the 'boosterish' forecast its masters in Number 10 want.

But third, there is something worse. This is that the BoE is staffed by economists for whom maths is king, and they program all their forecasts to predict a return to the mean - because that is what they think mathematically always happens. So what we see here are forecasts which track the quickest possible return to the mean that the Bank's forecasting models permit. And rather than observe conflicts with reality and then adjust for them they continue to publish their model's results.

In fairness, they do say that the downside risks in their forecasts are considerable, and exceed upside risks. That's the one thing they got right.

I fear that things will be much worse than the Bank forecast. But I would be happy to be wrong.