Is the Bank of England to blame for the UK's above-target inflation?

A presentation by Professor Tim Congdon CBE,

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Andrew Bailey's denial of responsibility for above-target inflation 1.

- On 16 May Andrew Bailey, Governor of the Bank of England, gave evidence to the Treasury Committee of the House of Commons. Why had inflation taken off?
- Bailey said that neither he nor his colleagues at the Bank of England were responsible for the inflation overshoot.
- Instead "a sequence of shocks" to costs and prices has been "unprecedented". He cited

i. the surge in energy prices and

ii. a supposedly "apocalyptic" jump in food prices related to the Ukraine war, coming soon after

iii. supply-chain disruptions and "the lingering effects" of Covid.

Andrew Bailey’s denial of responsibility for above-target inflation 2.

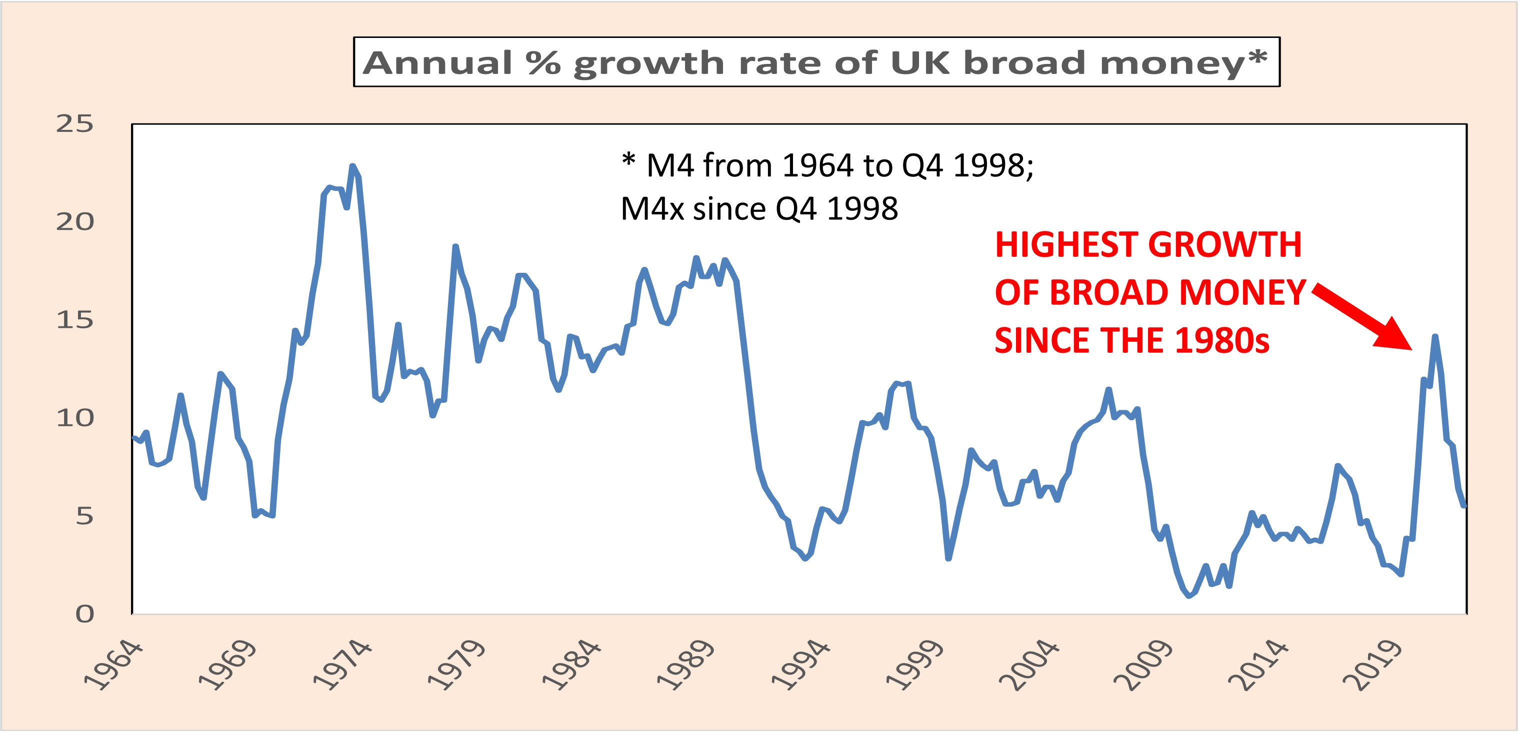
- Britain’s excess inflation was due only a limited extent – 20 per cent, according to Bailey – to domestic forces.
- In his view, 80 per cent of the upward pressure on the consumer price index was driven by global circumstances outside the Bank’s control.

A letter in the *Financial Times* on 26 April 2021, from the Shadow Monetary Policy Committee

- The following letter appeared in the *Financial Times* on 26 April under the heading ‘BoE [Bank of England] must end its asset purchases to avoid stoking inflation’. To quote,

We believe that above-target inflation is to be expected in 2022 and perhaps 2023. In our view, the Bank of England will be to blame for this setback, as it took the measures that have pushed money growth to its current excessive level… We fear that inflation above 5 per cent is likely at some point in the next few years. We judge that the MPC’s decision in November 2020 to embark on another round of quantitative easing, to the tune of £150bn, has proved particularly responsible for the current excessive money growth.

The central mistake: a failure to keep money growth consistent with the 2% inflation target

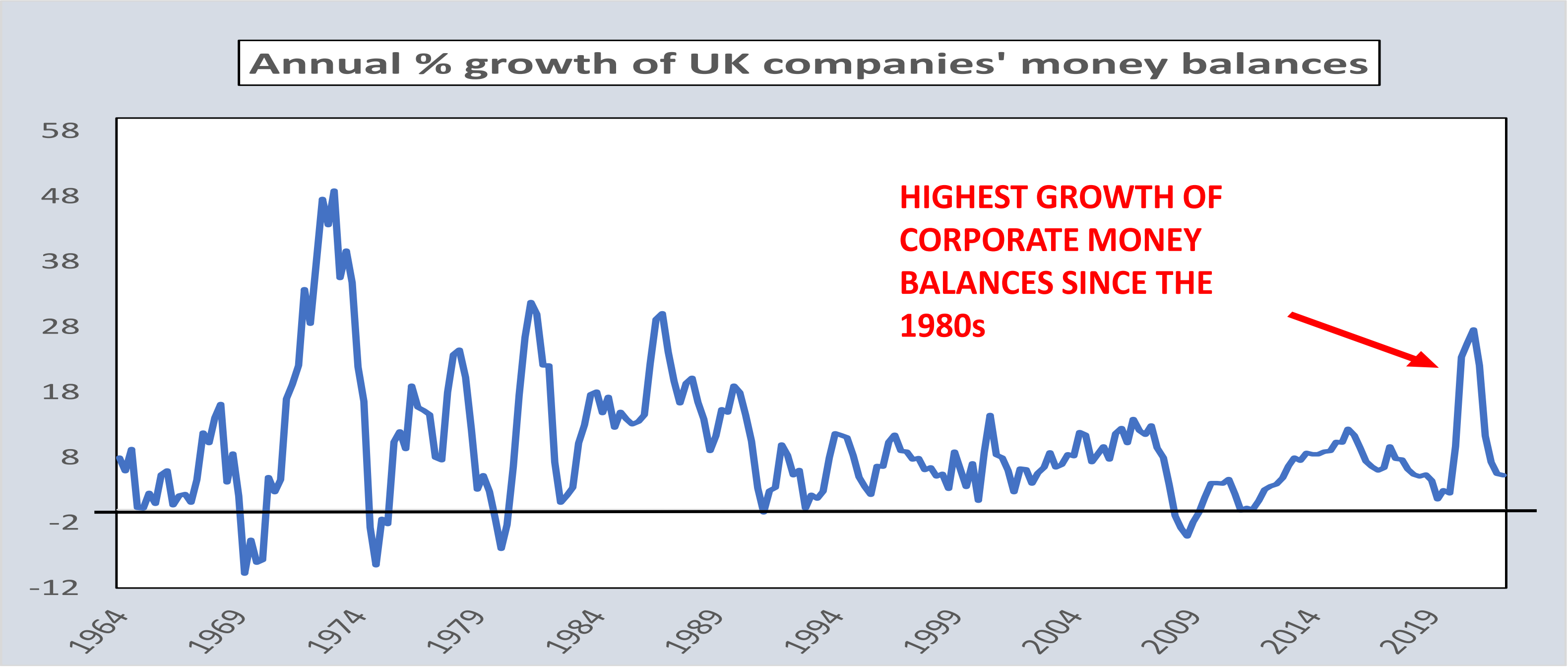


A letter in the *Financial Times* on 26 April 2021, from the Shadow Monetary Policy Committee

- The 26 April letter in the *Financial Times* noted that,

[Some] money series have been prepared on a consistent basis since 1963. One such series shows that companies' increase in money balances in the year to February was no less than 29.2 per cent. Numbers as high as this have been previously recorded only in the inflationary 1970s and 1980s. The last time an annual growth rate of company money reached 30 per cent was in late 1986, ahead of the boom years of 1987 and 1988.

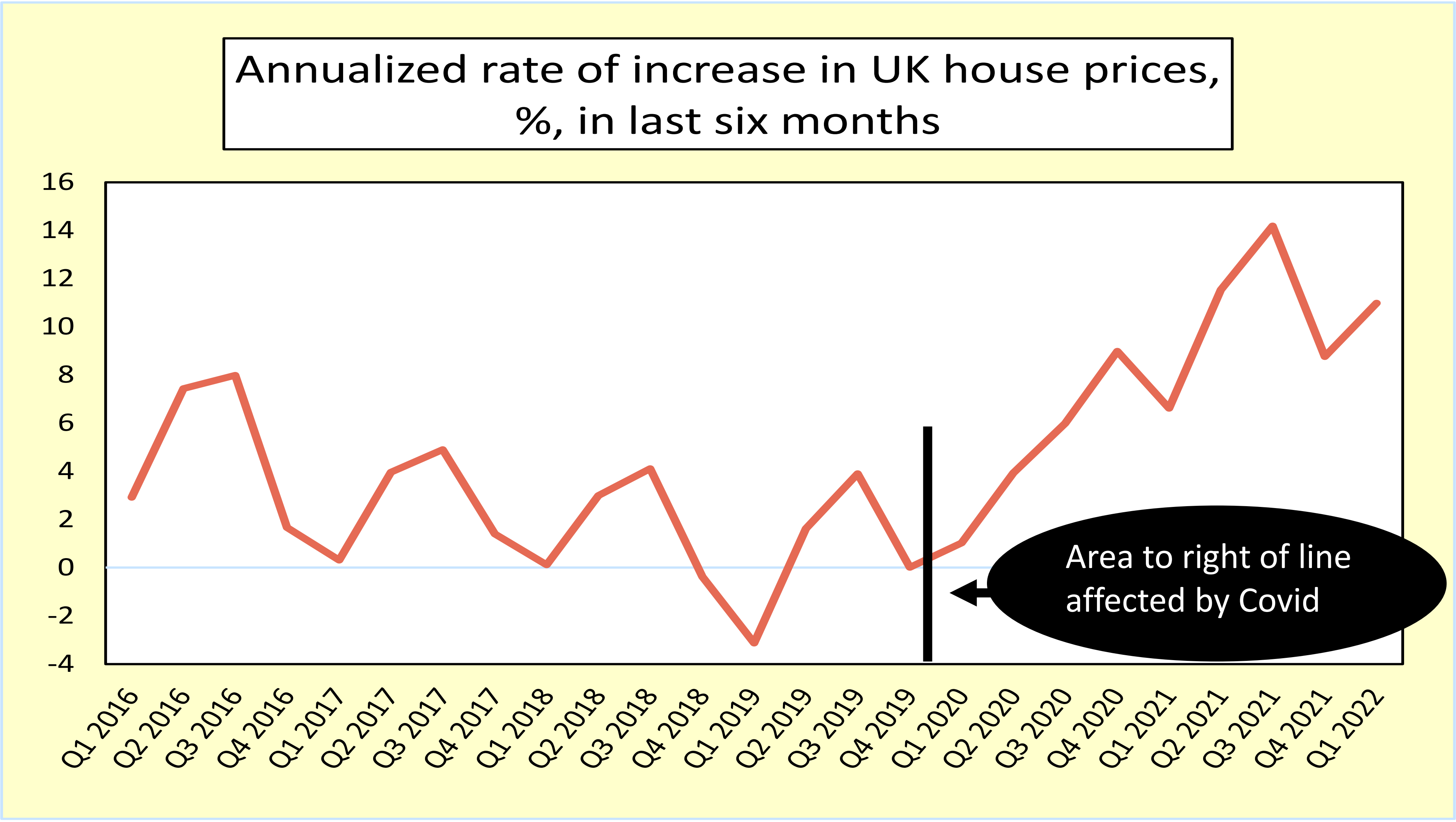
The central mistake: a failure to keep money growth consistent with the 2% inflation target



Three errors in Bailey's comments

- 1st. **Confusion between the absolute price level and relative price movements.** It is always possible to explain movements in a price index by an analysis of movements in its components. After all, every inflation rate is the result of price increases!
- 2nd. **Inflation rates differ enormously between countries, even though they face the same 'shocks' from global commodity price swings etc.** Switzerland's consumer inflation at present is only 2 ½%. By limiting money growth, a central bank makes it more likely that the currency will appreciate on the foreign exchanges and curb the damage to inflation.
- 3rd. Inflation in goods and services is **part of a wider inflation problem, with very buoyant asset prices**. But the prices of houses and corporate equity are clearly not affected by Bailey's 'unprecedented' supply-side shocks.

	Increase in the quantity of money in the three years to December 2021, %	*Increase in consumer prices in the two years to April 2022, %*	*Increase in consumer prices in the year to April 2022, %*
USA	**44.2**	12.7	**8.2**
Canada	29.9	9.8	6.8
Eurozone	25.2	9.2	7.4
UK	26.0	9.6	9.0
Japan	13.9	1.3	2.5
Switzerland	**9.0**	2.9	**2.5**


Annualized rate of increase in UK house prices, %, in last six months
16
14
12
10
8
6
4
2
0
-2
-4
Area to right of line affected by Covid
Q1 2016
Q2 2016
Q3 2016
Q4 2016
Q1 2017
Q2 2017
Q3 2017
Q4 2017
Q1 2018
Q2 2018
Q3 2018
Q4 2018
Q1 2019
Q2 2019
Q3 2019
Q4 2019
Q1 2020
Q2 2020
Q3 2020
Q4 2020
Q1 2021
Q2 2021
Q3 2021
Q4 2021
Q1 2022

UK house prices and Covid-19

Before the Covid pandemic

- In the two years to Q1 2020 UK house prices, using the Nationwide 'all houses' index, rose by **2.9%**.

After the start of the Covid pandemic

- In the two years to Q1 2022 UK house prices, on the same basis, rose by **19.7%**.

The apparent puzzle of UK house price inflation

- Covid-19 was bad for the UK economy, as it was for all economies, and *by itself* was plainly negative to house prices…and indeed asset prices in general.
- **But UK house prices rose by almost 20% in the two years from Q1 2020, i.e., from the start of the Covid pandemic, compared with about 3% in the preceding two years.**
- The house price jump was part of the general inflation story – and, very clearly, had nothing to do with unprecedented supply-side shocks, cataclysmic food price movements, etc.
- **The obvious explanation for the surge in house prices – which resembled that in previous boom-bust cycles – was excessive growth of the quantity of money.**

Allocating blame

- **The Bank of England is very much to blame for the current inflation upsurge…**
- **…as are the Federal Reserve and the ECB for the bad inflation news in the USA and the Eurozone respectively.**
- The failures of economic policy are the result of decisions taken by economic policy-makers. To be clear, by criticising the Bank of England, I am not excusing the Treasury…

Allocating blame

- And, at another level, it has to be conceded that both the Bank and the Treasury operate in a climate of opinion and advice…elite opinion and advice, if you wish.
- Writing in the *Financial Times* on **22 June *2020***, Gavyn Davies, formerly chief London economist at Goldman Sachs, judged that the surge in public debt should be viewed as a "shock absorber". In his view, policy-makers enjoyed **"a chorus of approval from the profession"**.