

Why no inflation?

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The question of inflation is coming up time and again in the Labour leadership election. [Yvette Cooper is certain that](#) People's Quantitative Easing will lead to a mass outbreak of hyperinflation in the UK. It's time to address the issue.

First, some general background. PQE is simply a way of injecting money into the economy. Such injections have happened before: £375 billion happened from 2009 to 2012. The US has only just stopped its QE programme. Japan is still doing one. The EU is near the start of a €1-trillion programme. Money printing is normal. There has been or will be about €5 trillion of it over a relatively short period.

And around the world there is almost no inflation. After QE the UK has got to zero inflation.

Japan would love inflation but can't manage it.

The whole point of the EU programme is to create inflation, and many doubt it will.

In the US the inflation rate is 0.2%.

What is more, as the [FT reports this morning](#), a Boston Fed official with some influence is today reporting that the Chinese slowdown is already making him doubt that the US can reach its 2% target inflation rate anytime in the foreseeable future. I have some considerable sympathy with that view. In fact, let me summarise what almost all the world's central bankers are looking for right now: it is a magic bullet that might create the inflation that they want.

So the question has to be asked as to why they can't get it? The [Wall Street Journal](#) raised this question last week. As they noted:

Central bankers aren't sure they understand how inflation works anymore. Inflation didn't fall as much as many expected during the financial crisis, when the economy faltered and unemployment soared. It hasn't bounced back as they predicted when the economy recovered and unemployment fell.

As they then note, this is a massive issue. If you can't predict inflation then what is the point of central bank independence which is all about controlling inflation as if it is the only task of significance in an economy? What if, in other words, all the priorities are wrong and for reasons central bankers and some well-trained economists (like Yvette Cooper) don't understand inflation simply is not the threat it was? And in that case what new policies are needed?

Let me explain why I think the inflation conundrum exists i.e. why we can't deliver the inflation we want.

First, it's because inflation measures are measuring the wrong things. We have had massive inflation in asset prices, for example, many of which have real impact on well-being, but asset price inflation is not included in our inflation measure.

Second, some inflation measures fail to measure the right things. So, for example, in the UK there is a current belief that we will have inflation soon because we supposedly have wage inflation right now. But firstly, that is wage inflation after eight years of decline and with GDP per head only at pre-crash levels. And second, this measure might be hopelessly inaccurate. That's because it excludes the earnings of the at least 5 million UK self-employed, who we know have had seriously declining income. That decline may be enough, given their number and the relatively small increases in wage growth to neutralise that wage increase impact entirely: the reality is that this measure of apparent inflation might be completely wrong.

Third, what the decline in self-employed earnings shows is that inflation risk is being outsourced: it is now passed on to some elements within a profoundly deregulated labour force, many of whom are suffering unrecorded real earnings decline of such extent that they are in poverty, but so destabilise the rest of the labour market by accepting any offered pay rate (which rates are beyond the control of minimum wage regulation) that any amount of upward pressure on prices can simply be externalised into this unmeasured pool of labour meaning that anticipated inflation outcomes simply do not happen.

I stress, I am speculating. But let's suppose across 25 million workers there is a 2% pay rise and across 5 million self-employed people a 10% wage drop (which is not impossible) then there is no net wage inflation at all: the wage rate data is just wrong as a result because it is missing an important variable that did not matter at one time but is now deeply significant.

In that case the amount of inflationary pressure in the UK economy might well come back to being effectively nothing at all, whilst we have at the same time unemployment, under-employment and a stark need for real investment which is the only way to boost earnings growth for those most in need of it, which is the only true

economic goal a Treasury and a central bank should have. But because of poor inflation measures, poor theory and poor appraisal of why we do not have inflation at present, when if theory was right we should, we are denied that possibility of investment for the common good. I find it deeply frustrating that adherence to economic thinking that is obviously past its sell-by date should be used to oppose necessary ideas for reform that could massively benefit the people of this country.

Yvette Cooper is an able person. She seems to have read Keynes. She would be wise to recall his maxim that:

Practical people who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.

I fear that may be the case.

It is time to move on. There is no inflation risk right now. PQE probably will not change that: if it did then without major labour market reforms the impact would be modest, at best. But many wish for even that modest inflation impact, and most of them are central bankers. Yvette Copper should take note.