On interest rates, growth and the need for the most ma...

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The FT has reported that:

The Bank of England says "further modest increases" in interest rates are likely as it tries to bring inflation down to its target of 2 per cent in the next few years.

This comes after the Monetary Policy Committee left rates unchanged despite inflation increasing to 3.1 per cent in November. As the FT continued:

Markets expect the BoE will raise interest rates up to twice next year, once in May and a possible second time towards the end of 2018, bringing them from their current levels of 0.5 per cent to 1 per cent by the end of the year.

Before noting:

Though borrowing would become more expensive, 1 per cent would still represent a historically low interest rate level and could still encourage households and businesses to borrow and spend.

And suggesting:

The committee believes the UK economy cannot grow much faster than 1.5 per cent a year without pushing up inflation. As a result, the bank's outlook for the economy and living standards remains weak – leading members to stress that more interest rate rises are likely to become necessary.

Three comments seem appropriate.

The first is that it seems increasingly absurd that the MPC is only worrying about inflation. In part that's because the country could do with some to assist those in debt manage the burdens they face. It's also because the measure is simply so crude, failing to take into account so many impacts on the economy arising from issues over which the MPC has no real control, whether by interest rate changes or by conventional quantitative easing. And it is because the goal is now so contradictory when it is believed that we must have growth to see an increase in real wages and yet any sign of growth must be snuffed out at birth by an interest rate rise for fear of inflation. What the policy inevitably means is we are doomed to stagnation in living standards.

Second, this suggests that the Bank of England badly needs a better measure for economic targeting, but this has to be set by the government: it is not for it to set in isolation. The logic of using interest rates to manage inflation is so now so hopelessly inappropriate for the UK economy (and the vast majority of the people who live in the country) that urgent change in policy priorities is overdue if the cycle of guaranteed despondency in which we are stuck is to be broken. Charles Adams has suggested that targeting increasing median income makes sense and I have a lot of sympathy with that.

Third, the idea that the Bank of England, or anyone else, has the foresight to forecast growth next year for the economy when there are so many massive headwinds facing the country undermines their credibility at present. More caution, a little more wisdom, and a demand that the government play its role with fiscal policy to which the Bank might lend a hand, might have been appropriate, I suggest. But that's not what we got from a body dedicated to conventional wisdom. In which case a minor revolution in thinking is required.