

Funding the Future

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I wrote this tweet yesterday:

<https://twitter.com/richardjmurphy/status/1662485945856172032?s=61&t=fQEnD35XLiGihXLT1M1wyA>

The FT piece said:

Jeremy Hunt has backed further interest rate rises to bring prices under control as figures showed only Argentina and South Sudan experienced bigger increases in underlying inflation last month.

My speculation is a straightforward one.

First, we know that inflation happens because companies increase prices.

Second, we are told (contrary to much evidence) that they are not increasing profits.

So, third, they must be increasing prices because their costs are increasing. Those costs come in three forms:

- * Bought in goods and services.
- * Labour.
- * Interest financing costs.

We know raw material prices are almost universally falling. [I have documented that.](#)

And we know wages are lagging inflation, being a long way behind, so they cannot be to blame here.

So, what about interest? The Bank of England is putting up rates as fast as it can and is determined to leave rates as high as possible. Its obvious goal is to create long term positive real interest rates for the first time since pre-2008. Suppose rational businesses have noticed this and are putting up their costs to cover these anticipated interest cost increases, which are a major part of their expenditure? Interest costs account for 30% of the income of water companies, for example, although they are a

bit extreme. For business to do this would be entirely rational.

But that would mean that we have an interest rate / inflation spiral in the UK that is being driven by the Bank of England and the policies it is supposedly putting in place to tackle inflation, when (as they say we must) we take future expectations into account.

I am suggesting that this is at least plausible. Given the Bank's denial of other possibilities, or the denial of the possibility of inflationary wage / inflation spirals by the IMF, amongst others, and in the absence of other variables that can now be having rational impact, this one seems to me to be one of the best explanations for ongoing inflation now. Business is now rationally expecting its interest costs to remain high into the future and is increasing prices accordingly.

I suspect the Bank to deny this, but they have already admitted their models of inflation based on their own understandings of the issue do not work, so little weight should be given to that.

Instead it's time to cut rates and remove the only excuse businesses have to increase prices because interest rates are the only cost expected to remain high, and excessively so, from now into the future.