Funding the Future

People make up the economy, and not finance, which migh...

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Costas Milas, a professor of finance at the University of Liverpool, had an article in the FT yesterday.

I admit that I am not sure that all of it managed to differentiate causation and correlation. I would therefore take all of it with a pinch of salt, but three conclusions stood out. One was:

Money growth has been found to predict UK growth quite well, and more so when UK growth is quite weak. In fact, very weak annual GDP growth rates since mid 2022 (annual growth in the second quarter was just 0.4 per cent) are directly associated with the big drop in money ... [supply].

This is what I had a problem with: the change in money supply has to be very big and the growth rate already very small for this effect to be noticed. Is that just a coincidence then without there being causal link in that case?

Much more interesting was this:

The... BoE's inflation quantitative models could benefit from considering [the] public's expectations for inflation because the latter potentially caries the same or even better predictive power than the Bank's own inflation forecasts. Such expectations certainly matter: they increase worker demands for higher wages and, therefore, add to inflationary pressures.

From this, he concluded:

Public expectations of inflation have a better explanatory power than the Bank's own forecasts in dictating UK inflation movements. This is clearly a problem for the Bank's policymakers, whose forecasts are (supposed to be) more sophisticated than those formed by the public.

To put it another way, walk about and talk to people to find out what is going on. That, when it comes to economic forecasting, is much more important than anything that the

Bank of England does by sitting in it ivory tower with all its financial models.

The reality is that people make up the economy, and not finance.

Will the BoE listen? I doubt it.