Funding the Future

Rachel Reeves does not understand what is happening and..

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I have [already referred in another post]() to some of the economic nonsense that Rachel Reeves wrote yesterday in [the Daily Mail](). I failed to note another of her absurd claims, which was in this section:

Is Rishi Sunak being honest with you about his record in power? No… [He] will tell you that he got inflation down. He didn't.

Inflation rose when he was Chancellor of the Exchequer and it has only fallen because of the decisions taken by the Bank of England to hike interest rates, leaving homeowners paying higher mortgage bills.

As regular readers will know, I have long argued that this is utter nonsense. As even the Bank of England has acknowledged, inflation in the UK arose because of external factors. That began with price shocks from Covid reopening and then continued with oil and food price shocks arising from the war in Ukraine. These then created knock-on effects on other prices.

And, as I always argued, as these shocks worked through the system, price changes were always going to return to normal rates, as they have now done.

This is true for all major economies. The scale and speed of change vary a little, but the similarities are vastly more on iota than the differences.

So did the Bank of England's interest rate increases do anything to solve the problem? No, precisely nothing at all. The problem was solved by the shocks passing through the system.

This is confirmed by a [new academic paper by IMF researchers]():

Understanding the International Rise and Fall of Inflation Since 2020

By Mai Chi Dao, Pierre-Olivier Gourinchas, Daniel Leigh, Prachi Mishra[1]

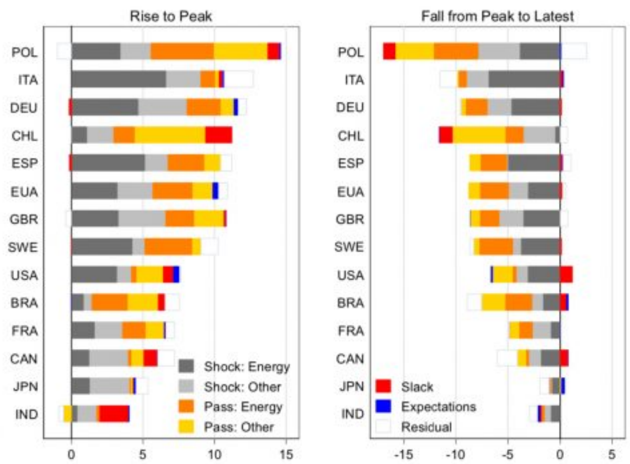
May 2024

This paper analyzes inflation dynamics in 21 advanced and emerging market economies since 2020. We decompose inflation into core inflation as measured by the weighted median inflation rate, and headline shocks—deviations of headline inflation from core. Headline shocks occurred largely on account of energy price changes, although food price changes and indicators of supply chain problems also played a role. We explain the evolution of core inflation with two factors: the strength of macroeconomic conditions—measured by the unemployment gap, the output gap, and the ratio of job vacancies to unemployment—and the pass-through into core inflation from past headline shocks. We conclude that the international rise and fall of inflation since 2020 largely reflected the direct and pass-through effects of headline shocks. Macroeconomic conditions generally played

As they make clear, the shocks were external. The inflation was not made here.

But as they also note, the decline from the peak rate of inflation - most especially in the UK - was simply because the shocks passed:

Figure 8. Accounting for the Rise and Fall in Headline Inflation, 2020-2024: Fourteen Economies
(Decomposition of change in twelve-month headline inflation from December 2020 to peak in 12-month headline inflation; and from peak to March 2024; percentage points)



Sources: Haver analytics; Federal Reserve Bank of Cleveland; Statistics Canada; and authors' calculations.
Note: "Shock" denotes contribution of headline inflation shocks (energy or other). "Pass" denotes pass-through from headline inflation shocks (energy or other) into core inflation. "Energy" denotes contribution of relative energy prices. "Expected inflation" denotes contribution of change in long-term inflation expectations to change in headline inflation. "Slack" denotes contribution of change in economic slack (ratio of vacancies to unemployed for United States and Canada; output gap for Brazil, Chile, India, Poland); and unemployment gap (the remaining seven economies). Based on estimates in Annex Table 3 and Annex Table 6. Data labels in the figure use International Organization for Standardization (ISO) country codes except for EUA (Euro area).

Monetary policy by the Bank of England eased both utterly unnecessary and simply created a new crisis caused by high interest rates and rents.

In that case, the analysis Reeves offered in the Daily Mail is totally untrue. Or wrong. Or unevidenced. Or grossly misleading. And totally unwise. You take your pick. Whichever it is, it reveals her as totally unsuited to be Chancellor because she simply does not understand what happened and why in the economy for which she wishes to be responsible. And that is profoundly worrying.