

Funding the Future

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In this morning's video I note that inflation is always a temporary phenomenon that always cures itself. History proves that. In that case to make it the epicentre of economic management in the UK is absurd. We need much better goals if the country is to make progress, whether on employment, inequality, investment or climate change.

https://www.youtube.com/watch?v=wcTL29bhcWE?si=ZP1b_HglabS7fBW7

The audio version is here:

https://www.podbean.com/player-v2/?i=km227-16c3b65-pb&from=pb6admin&p;share=1&download=1&rtl=0&fonts=Arial&skin=c73a3a&font-color=&logo_link=episode_page&btn-skin=ff6d00

This is the transcript:

Why are we obsessed with inflation?

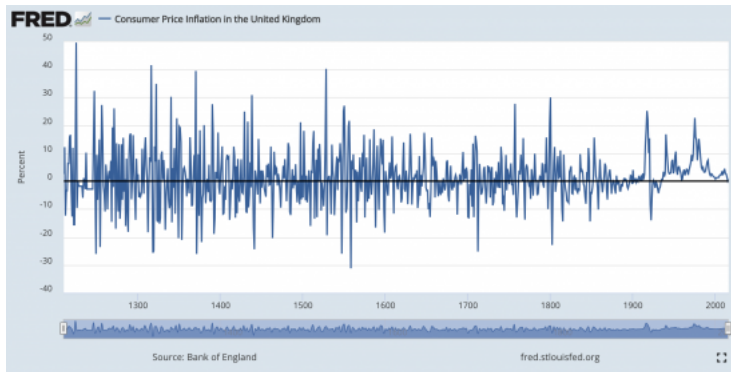
One of the questions that Danny Blanchflower and I will be asking as we work as the Mile End Road Economists is just that because we know that the City of London is obsessed with inflation.

We also know that successive Chancellors of the Exchequer have been.

But the truth is, there's no real evidence that we need to make this the focus of all economic policy, which is what it has become, most especially since the Bank of England was made independent and was given the single goal of controlling inflation as

the one and only target it had for running monetary policy in this country.

Let's have a quick look at this chart. I've shown it before on this video series, and I have little doubt I will show it again. Because it is a chart produced by the St. Louis Fed, which is one of the central reserve banks of the USA, but which actually is based upon data from the Bank of England. And it shows the inflation rate in England, and then in the United Kingdom, over periods from 1210 to date. And I do really mean 1210 A.D. It is that long a chart because there has been sufficient data to estimate inflation over that period of time.



Now look at how that chart moves. Every time it spikes upwards, and it does very heavily on occasions, very soon afterwards it shoots heavily downwards.

In fact, the pattern until about 1900 was for a period of inflation to be followed very quickly by a period of serious deflation. In other words, after a period of prices rising, there was a period when prices fell.

Now since 1900, I would agree, the pattern has changed. Quite clearly, we haven't suffered any significant deflation with them. But even so, what still happens is that once we have a period of inflation, things rapidly go back to normal. In other words, the inflation rate goes back to a very low level really quite quickly.

And of course, this is exactly what happened in the period after 2021 when inflation started in the UK.

We had quite heavy inflation during 2022, and for all practical purposes, inflation has now disappeared in 2024.

So there has been complete consistency in the recent episode of inflation with this historic pattern.

The pattern is so consistent in fact we can say this is what always happens.

Inflation is always caused by some form of shock.

In the case of the recent episode of inflation there were two shocks. The first one was reopening from Covid. We know that there were severe supply chain disruptions as soon as the COVID reopening took place because people who had been saving during the COVID era suddenly wanted new cars, new kitchens, new everything and had the money saved up to buy them.

And because they had excess money, because they had been saving, not because of furlough, nor because of the creation of new money, but because they simply hadn't had the opportunity to spend, there was the beginning of an inflation spike.

And that was then exacerbated by Putin invading Ukraine. That led to financial markets speculating that there were going to be shortages of all sorts of raw materials. Petrol, gas, fertilizers, wheat, you name it; apparently, we were going to be short of it. In fact, none of those shortages happened. But, we saw an inflation spike because the financial markets pushed prices up as if there was going to be a shortage, even though there never was one.

And that panic is really why most inflation happens. The shock creates a panic reaction; the panic reaction quickly is normalised because people realise that the panic was unnecessary; the shock is over, and things go back to normal.

Now they don't go back to deflation; in other words, prices don't tend to fall back to where they were, which is the pattern from history, but they always go back to low levels.

So why are we obsessed about inflation in that case?

And why are we making the Bank of England Monetary Policy Committee run monetary policy in the UK as if inflation is the only thing that matters when, in practice, we had no serious inflation at all from about 1995 until 2021?

Now, I'm not saying there was never any inflation risk in that period, but in practice, there was hardly any. And there might well be none for some time to come, until we get another external shock. Even 2008 couldn't create one in this particular case.

So, inflation is not the threat that everyone pretends it is. And in that case, Danny Blanchflower and I will be saying, "Why does the Monetary Policy Committee have the job of running monetary policy, that is the interest rate setting policy of the UK, with the aim of eliminating inflation when, frankly, when inflation happens it goes away of its own accord, without having to change interest rates, and why does it have to do this when there are much greater priorities to address?"

For example, the priority could be full employment. It could be a reduction in inequality. It could be something to do with green climate change because the Bank of England claims it has interest in that subject.

Whichever one of those it is, and full employment seems to be the first and most obvious one, because most other things would follow from that, it would be better than targeting something which is no great threat, and which always deals with itself.

Why, then, does the Bank of England focus on something which, frankly, is almost irrelevant?

Let's look at something much more important is the point we will make, and that something much more important is either full employment or it's investment, or it's the green environment, or whatever you wish. But let's not make inflation our primary goal.