

## Central banks failed on inflation

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Central banks claim they defeated inflation by raising interest rates. The evidence suggests otherwise.

In this video, I look at seven major economies, including the UK, USA, Eurozone, Canada and Australia, and show why inflation was largely driven by supply shocks, not excess demand.

I also explain why inflation was already falling before many interest rate rises had been completed, why higher rates may now themselves be feeding inflationary pressure, and why the social costs of these policies have fallen hardest on working people.

The result is a serious challenge to the entire theory behind modern central banking.

This video also asks whether so-called independent central banks are really independent at all, when they all reacted in almost exactly the same way to the inflation crisis of 2021 and 2022.

The evidence suggests central banks reacted too late, used the wrong tools for the wrong problem, and may now be trapping economies in a cycle of structurally high interest rates and persistent inflation.

So, has the whole model failed?

<https://www.youtube.com/watch?v=dkT7wyVSjs0?si=GAeXPuiGes5gPrqm>

This is the audio version:

<https://www.podbean.com/player-v2/?i=4hxsu-1aca5b4-pb&from=pb6admin&>

The 'Debate Ammunition' for today's [video is available here.](#)

This is the transcript:

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Central banks like to claim that they can beat inflation, but the claim does not hold up when we look at the evidence.

A consistent story is being told. Central banks acted decisively, they say, in 2022, and as a consequence, inflation is now back under control.

That's a very convenient story if you're a central banker, but it is also very largely untrue. The evidence from seven charts tells a very different story.

Those charts cover bank base rates and CPI inflation across many major developed economies during the course of this decade, and what the charts reveal is not a triumph; they are a demonstration of the limits of central banking.

The reality is that those seven charts all show that inflation surged during 2021 and 2022. And that's the case across the UK, the Eurozone, the USA, Canada, Australia, New Zealand, and Sweden, which I added in as a non-Euro-using EU country.

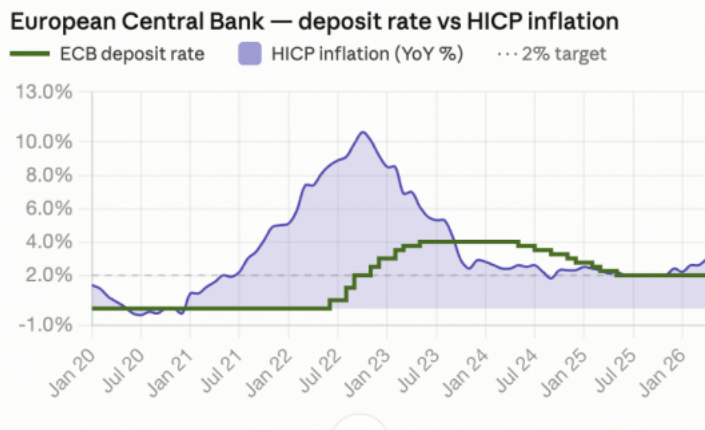
We know the causes: supply chain disruption after COVID and then speculative turmoil after Russia's invasion of Ukraine. And then they tightened interest rates very aggressively by increasing them significantly before then cutting bank base rates again.

The moves weren't precisely synchronised, but they were remarkably similar. So much then, for so-called central bank independence. These banks do not look as though they were independent of each other. They might have been from their central governments, but there was one combined mindset amongst them, and that to me suggests that the claim of central bank independence is itself fundamentally flawed.

But let's come back to the charts. In every single case, what they show is that inflation fell back, and that happened before most of the interest rate rises were complete. The fall back was largely because the original supply shocks, which had created the inflation, had eased, and had nothing to do with the rate rises.

But in addition, and this is the key point, in many cases, inflation has now settled above target - usually 2% - while interest rates remained far above pre-2022 norms.

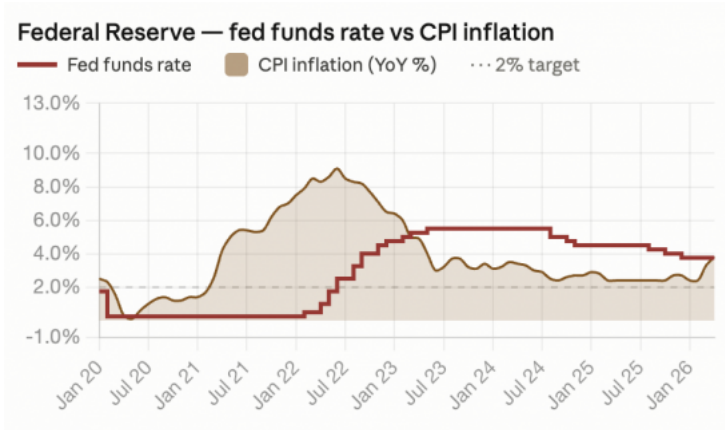
Let's look at the first chart. This is for the European Central Bank, and it was dangerously late in reacting to the situation that developed in 2021 and early 2022 as a consequence of the surge in Ukraine.



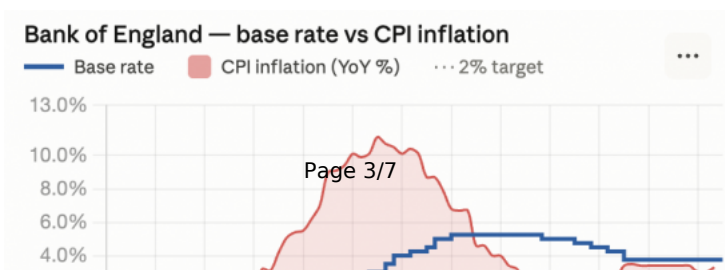
The ECB, European Central Bank, kept its deposit rate at zero while Eurozone inflation rose above 10%. It didn't, in fact, begin raising rates until July 2022, long after inflation had by then become embedded. By that point, inflation had been climbing for over a year with no monetary response, which questions the whole basis of their belief in the use of inflation as a policy tool to tackle inflation in the first place.

The delay meant prolonged deeply negative real interest rates across the Eurozone, and borrowing was effectively subsidised in real terms during this period. Asset prices rose as a result. Property markets were overheating and household living costs surged, a pattern that was repeated everywhere that we are going to look at.

The Federal Reserve in the USA reacted a little earlier than the European Central Bank to rising interest rates. It started raising rates in March 2022, despite inflation having already reached 7.5% at that time on a rising trajectory.

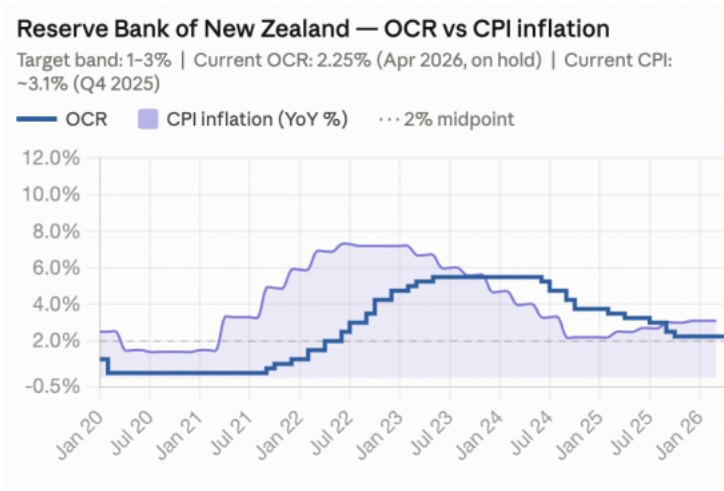


And the Bank of England reacted a little earlier than both the European Central Bank and the US Federal Reserve.



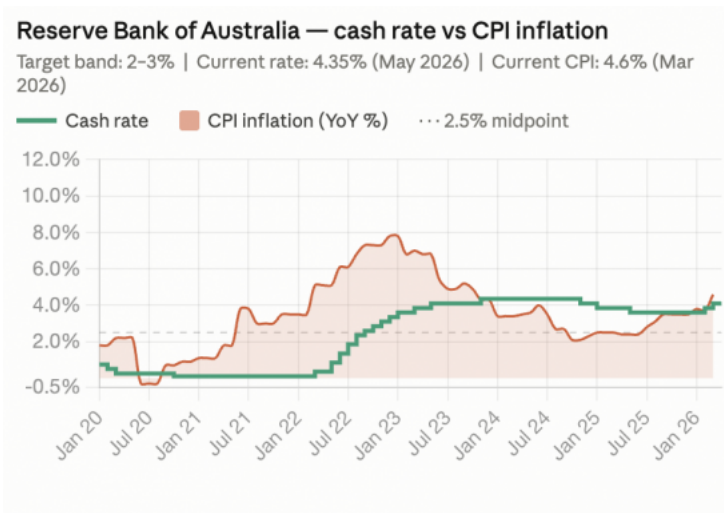
It began raising its interest rates in December 2021, but its first move was an increase of just 0.15%, which, if it really believed that bank interest rates were the mechanism to use to tackle inflation, was a wholly inadequate response given the inflationary pressures that were already evident in the UK economy by then.

Only New Zealand came close to acting in a timely way, and even there, inflation exceeded 7% in the end.



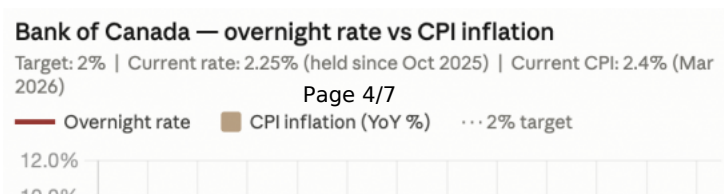
The idea that central banks anticipated and controlled inflation is, then, very hard to sustain. The evidence points firmly in the other direction.

The Reserve Bank of Australia took another approach. It had stated in 2021 that its base rates were unlikely to rise until 2024.



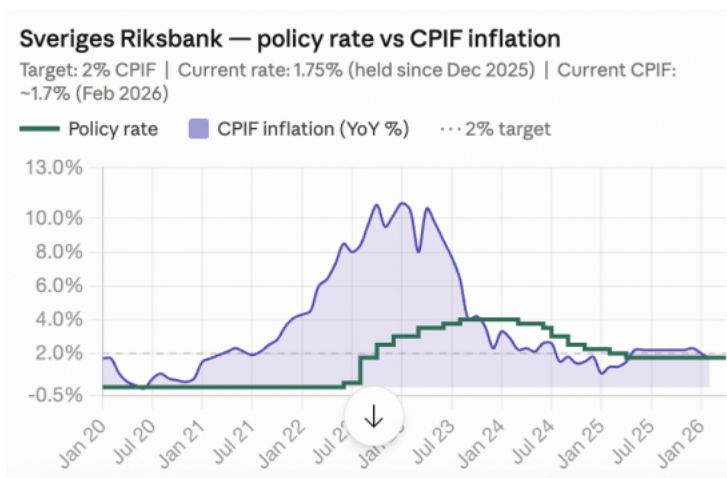
Stepping back from that was a policy problem for it, and it then had to abruptly reverse course and begin raising rates from May 2022. In Australia, renewed inflationary pressure had already emerged after the rate cuts began.

Canada followed a similar trajectory, slow to act, then aggressive, and now facing renewed uncertainty, and Canada faces another dilemma.

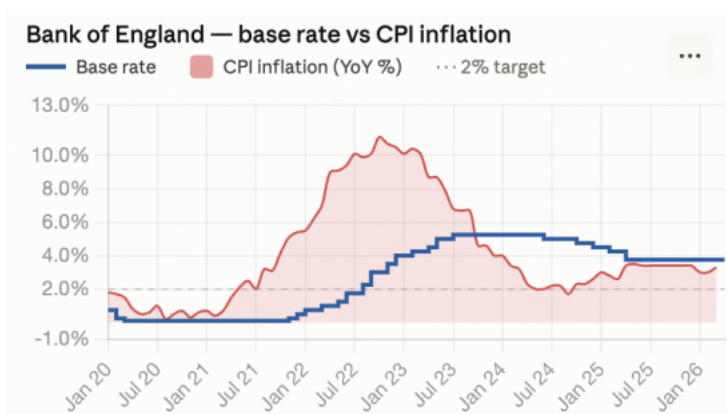


Further cuts risk reigniting inflation, but holding rates high sustains the pressure, and these are not isolated cases; they are part of the consistent pattern that the charts reveal.

Sweden went too far the other way, cutting rates so aggressively that inflation is now undershooting targets in that country.



The UK illustrates a different trap. Bank rate is still far above 2022 norms, and yet inflation remains way above target. Service inflation in the UK remains persistently high, and the Bank of England appears genuinely uncertain as to what to do next, especially as there is an emerging crisis in the Gulf, which is going to increase inflation, but which will also create significant downward pressure on the economy.



This is a problem in itself, and that is that high interest rates are actually feeding inflationary pressure, and I think this central paradox is beginning to be understood by the banks themselves now.

High mortgage costs, higher business borrowing costs and higher government debt servicing costs are all pushing up prices. Interest rates are not just tools used to control inflation; they are also contributors to it.

The fact is, you can't push up the price of money, which is exactly what central banks do when they increase interest rates, without increasing prices overall. And central banks did forget that, but maybe, just maybe, they're now becoming aware of it.

The fact is, though, bankers are using the wrong cure for the wrong illness. The inflation surge of 2021 and 2022 was driven by supply-side disruption and not by excess demand, and the entire theory of inflation which they are using presumes that there is excess demand in an economy, and we haven't seen that for a very long time.

Pandemic shutdowns, fractured global supply chains and Russia's invasion of Ukraine drove energy and food prices upwards, but it didn't increase demand. Higher interest rates cannot unload container ships, pump more oil and gas into Europe or reopen Ukrainian grain corridors, which was the theory behind the rate increases in 2022.

What higher rate increases did do was transfer costs onto households, businesses and governments. Mortgage payments rose. Consumer borrowing costs increased. Business investment became more expensive. Central banks responded to a supply-side shock with a tool designed to suppress demand, and that was the fundamental error on their part. And they all did it the same, again, I make the point, so much for central bank independence.

The distributional consequences of all of this were not an accident. Higher interest rates benefit savers, banks and holders of financial wealth. They penalise mortgage borrowers, indebted businesses and governments trying to maintain public services. The transfer of income from labour to capital became more explicit because of these higher interest rates, and that is not an accidental side effect of monetary policy. It is one of its defining characteristics.

The social costs imposed by these interest rate rises appear to have been largely unnecessary. That was especially true given that the inflation they were meant to tackle was actually very clearly coming down when some of these rate rises were still being imposed. The supply side shocks had already eased, and inflation had fallen, but not because central banks engineered a precise cure. They did nothing of the sort.

And now, having pushed interest rates sharply higher, central banks have not had the courage to cut them sufficiently again. The result is that inflation has not fully returned to target. Many economies now appear to be stuck in a new equilibrium of structurally higher inflation and higher interest rates. Central banks appear uncertain as to whether their own policy settings are now part of the problem, and they're hovering between competing risks and not managing any of them with confidence.

That uncertainty is itself a significant development, but it should concern us. The era of confident technocratic monetary management looks far less convincing than it once did. What we are seeing is the failure of central bank independence. Central banks were granted independence on the assumption that technocratic management would deliver

stable prices. The last five years have exposed the fragility of that assumption.

Inflation has surged. Central banks have reacted too late. Enormous social costs have been imposed, and all for absolutely no obvious gain.

Inflation eased largely because the original supply shocks diminished of their own accord and not because of monetary policy.

Many economies are now left with these structurally higher rates than they need, and a persistent residual inflation problem. That residual inflation problem may itself be driven by those overly high interest rates, and they are not now curing the problem, they are causing it.

We are living with a system of supposed inflation management that very obviously fails to deliver, and which might actually be causing harm. At the same time, we know it has imposed massive social costs while doing so; costs borne disproportionately by working people and debtors.

The cult of the independent central bank has, however, survived. It's worshipped as if it is always and forever correct. To challenge it, as I am doing now, is considered to be, well, heresy in economic terms. But the truth is that the evidence shows that we have suffered as a consequence of the policies that these banks put in place. They were indecisive, they were late, they were ineffective, and they're now causing harm.

It's time to say very clearly that this system is not working, and to ask the essential question, which is: should the era of independent central banks now be over?

The story that central banks are telling, that they acted decisively and restored stability, is not supported by the evidence. That's what these seven charts show. What we now know is that we have many economies facing the new trap of structurally higher interest rates, which are unjustified by the economic situations that they're in, and residual inflation reinforcing each other. The distributional effects are clear, and so we need a serious debate about whether central bank independence is still fit for purpose and whether it ever was.

I think it's time for independent central banks to go, but what do you think? There's a poll down below. Let us have your opinions. Please do like this video, if that's what you do. Please do share it. And if you're so inclined and you would like to make a donation to support our work in creating these videos, we'd be very grateful.

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## **Poll**

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