Funding the Future

My View On ... Inflation

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About a month ago, I began a series of posts that drew on my previous work to summarise my opinions on a range of economic topics. Doing so, I wrote them in the third person, but it became clear that this was unpopular. I have, therefore, rewritten one of those posts, on inflation, in the first person and share it below.

This is also an expanded and edited version of the previous offering.

I would appreciate comments on this revision, and if this style is more acceptable, there will be more articles of this sort over the coming weeks to provide a benchmark of materials summarising my opinion on key political-economic issues.

The Richard J Murphy YouTube Channel

And

My View on …Inflation

Richard J Murphy

This post is one of an ongoing series in which I set out my views on significant topics in economics, political economy, politics, taxation, and accounting. It should be read as such. It is an overview of a position I have developed across many years of writing and analysis, and not as a

comprehensive treatment. Where more detail is required, the reading list at the foot of this post is a good starting point.

Inflation is Not One Thing

Inflation is one of the most politically charged and persistently misunderstood concepts in economic debate, and I have spent a great deal of time over the last several years trying to disentangle what it actually is, what causes it, and what that tells us about the appropriate policy response.

The starting point, which is too rarely stated clearly, is that inflation is not a single, homogeneous event. Different inflationary episodes have different causes, and they require fundamentally different responses. The failure to recognise this distinction has produced some of the most damaging economic policy decisions in recent decades.

Demand-pull inflation, which arises when total spending in an economy exceeds its productive capacity, is what most textbook discussions of inflation describe. It is also, in my view, the less common type in economies and is characterised by persistent underemployment of labour and capital.

Cost-push inflation, driven by increases in energy, raw materials, or supply chain costs, is far more prevalent, and it calls for a very different toolkit from the interest rate mechanism that central banks reach for almost by reflex.

This distinction is not merely academic. It is the foundation of everything else I want to say.

What Actually Caused the 2021 to 2023 Inflationary Episode

The most severe inflationary episode in the UK in recent memory, which ran from late 2021 through most of 2023, has been widely mischaracterised. I have argued consistently, and I believe the evidence now confirms this beyond serious dispute, that it was caused primarily by supply shocks.

The first shock was the rapid and poorly managed reopening from the Covid lockdowns. Factories that had curtailed production could not immediately restore it, shipping routes could not be reopened quickly and costs rose sharply, and the simultaneous desire of many households to spend savings accumulated during the lockdown period created a mismatch between recovering demand and constrained supply. That was a short-term dislocation, and it would have resolved itself.

That first shock was then dramatically intensified by the speculative energy price explosion that followed Russia's invasion of Ukraine. The consequences for household

energy bills and production costs across the economy were severe, and they fed into the headline inflation figures with considerable force. The result was rates of price increase not seen in decades.

I have also argued that UK inflation was slower to fall than in comparable European economies, and the reasons for this are illuminating.

Our domestic energy pricing arrangements are particularly rigid, and the rigidity of the energy price cap meant that global price signals fed through to consumers with unusual speed and force during the rise and then did not ease with equal speed during the fall.

Brexit compounded this: the UK's diminished access to European supply chains and its more complex food import arrangements meant that prices for food were affected in ways that did not apply to our nearest neighbours.

On top of these supply-side factors, I identified a significant contribution from corporate profiteering, a phenomenon that came to be widely described as ‘greedflation’. Firms with significant market power, most obviously in energy supply, banking, and food retail, used the cover of a generalised inflationary environment to widen their margins beyond what underlying cost increases could justify. This was not a marginal phenomenon. The IMF itself concluded that corporate profit mark-ups accounted for a very substantial share of European inflation during 2022, and Christine Lagarde made clear that without a shift in corporate behaviour, interest rates would need to remain higher for longer. I said the same thing from the start. The evidence in the UK, from FTSE 100 executive pay to bank profit margins, confirmed it plainly.

Why Raising Interest Rates Was the Wrong Response

Perhaps the single most consistent argument I have made on inflation is that the Bank of England's response to this episode was fundamentally misconceived.

Raising interest rates is a tool for reducing excess demand. Applied to an inflation driven by supply constraints, energy price shocks, and corporate profiteering, it addresses none of the actual causes while inflicting serious harm on millions of households and businesses.

The Bank raised its base rate from 0.1 per cent at the end of 2021 to 5.25 per cent by August 2023. This was an extraordinary pace of tightening, unprecedented in the modern era of inflation targeting, and I argued throughout that it was not only ineffective but actively counterproductive. Higher borrowing costs raised the expense of mortgages and business loans. Companies facing higher interest bills passed them on to customers, feeding into the very cost base that was already under pressure. In this sense the Bank was contributing to inflationary pressure rather than suppressing it, while simultaneously transferring very large sums to savers and financial asset holders at the expense of borrowers, renters, and anyone with a variable rate mortgage.

The distributional consequences of this policy were not accidental, and I have been direct about saying so. Research from the Resolution Foundation demonstrated that the boost to savers' incomes from higher rates substantially outstripped the added cost to mortgage holders in aggregate. Three-fifths of all household income growth between late 2021 and the peak of the rate cycle flowed to those with savings. The age and wealth profile of those who gained overlapped very precisely with the core demographic of the party that was in government and nominally independent of, but in practice comfortable with, the Bank's approach.

I have also challenged the Bank's own intellectual coherence on this issue. Its published inflation forecasts showed clearly, months in advance, that inflation was going to fall as base effects worked through the statistical comparison period. Recorded inflation is, in significant part, a mathematical consequence of comparing current prices with those of a year earlier. When those elevated 2022 prices fell out of the annual comparison, the headline rate was always going to fall, regardless of what the Bank did.

The Bank knew this, published forecasts that reflected it, and yet continued to maintain rates at levels I regarded as unjustifiably high. There was, at times, a case for saying the Bank was not controlling inflation. It was, instead, the biggest driver of inflationary pressure in the parts of the economy it could actually influence.

The Arbitrariness of the 2 Per Cent Target

A related and important strand of my argument concerns the 2 per cent inflation target itself.

I have argued for a long time, going back well before the 2021 episode, that this figure has no credible theoretical or empirical basis. It was invented in the 1990s as part of the broader project of making central banks appear to be independent technical institutions rather than the agents of political choices that they always are.

The 2 per cent target was selected because it sounded reassuringly low, not because any analysis had demonstrated that 2 per cent optimised real economic outcomes. Nobody, to my knowledge, has ever been able to explain why the target is 2 per cent rather than 3 per cent, and I have put this challenge many times without receiving a satisfactory answer.

The reason the answer matters is not merely intellectual. If the target had been 3 per cent, the post-2022 tightening cycle would largely have been avoided. The misery imposed on mortgage holders, renters, small businesses, and everyone facing rising costs in a squeeze would not have been necessary. Millions of people were made worse off, not because the economy required it, but because the Bank was in pursuit of an arbitrary number.

The obsessive targeting of 2 per cent is particularly damaging in an economy subject to

repeated external shocks. In such conditions, modest inflation above the target may reflect adaptation to genuinely changed cost realities and is not in itself a sign of policy failure.

The appropriate question is not whether a specific number has been hit. The appropriate question is whether real living standards are being protected, whether employment is being maintained, and whether the economy retains the capacity to invest in its productive future.

Inflation in the MMT Framework

My approach to inflation is fundamentally shaped by Modern Monetary Theory, which I regard not primarily as a theory of government spending, though it certainly is that. but as above all a theory of inflation. This framing matters because it changes the way one thinks about the relationship between government policy and price stability.

In the MMT framework, inflation arises when total spending in the economy exceeds the real productive capacity available to meet it. A government that issues its own currency can always spend, but if it spends in ways that outrun the economy's ability to produce real goods and services, the consequence is price rises rather than real output growth. Taxation, in this framework, is not primarily about raising revenue. It is about withdrawing money from circulation so that the spending already undertaken does not generate excess demand and inflationary pressure.

This leads me to a position on the relationship between government spending and inflation that differs from both orthodox and simplistic heterodox views. I do not argue that governments can spend without inflationary consequence. I argue that the inflationary risk arises only when spending presses against genuine capacity constraints, and that whether such constraints exist is an empirical question requiring attention to the actual state of the economy rather than the automatic application of any single rule. Targeted spending that relieves bottlenecks, whether in housing supply, energy infrastructure, workforce training, or public health, can reduce inflationary pressure over time precisely by expanding the economy's capacity to meet demand without price rises.

Where inflation is driven by excess demand, some form of demand restraint may be warranted. But the form that restraint takes matters enormously.

Taxes on higher incomes and accumulated wealth bear far less social cost than interest rate rises, which penalise all borrowers indiscriminately regardless of income or circumstances.

Where inflation is driven by profiteering, the appropriate response is regulation, excess profit taxation, and competition policy.

Where it is driven by energy or commodity shocks, direct intervention in markets, including price controls and publicly provided energy alternatives, is more effective than any monetary policy instrument.

Interest rates, as a universal and reflexive response to all forms of inflation, are in my view a blunt and socially regressive instrument whose dominance reflects political choices rather than economic logic.

Problems With How Inflation is Measured

I have also raised persistent questions about the reliability of the inflation statistics themselves. This is not a minor technical point; it has significant real-world consequences for policy decisions, pay settlements, and benefit uprating.

A particular concern, which has since received wider attention, is that the Office for National Statistics has used official list prices rather than the prices actually paid by consumers. The gap between these can be substantial. Loyalty schemes, promotional pricing, and the structural pricing strategies of large supermarkets mean that actual prices paid often differ considerably from list prices. The consequence of this methodology was to overstate inflation as experienced by some households, possibly by a significant margin, with knock-on effects for every decision that was calibrated against the published numbers.

There are also more fundamental questions about what the headline inflation indices measure and whose experience they capture. The Consumer Prices Index is an average across a notional household, and the inflation experienced by those on lower incomes, whose spending is heavily concentrated on food and energy, is often sharply higher than the headline figure. A politically manageable headline rate can simultaneously represent a genuine crisis of affordability for households on low or fixed incomes. That gap requires explicit political attention rather than the assumption that a single aggregate number captures the diverse economic reality of twenty million households.

What Should Have Been Done Instead

My critique of orthodox inflation management is not purely destructive. I have consistently argued for a more effective and socially just approach, and the elements of it are not complicated.

Where energy prices drive inflation, as they emphatically did in 2021 and 2022, the appropriate tools are direct public intervention: price controls where market power is evident, windfall profit taxes on companies benefiting from commodity price spikes, and accelerated public investment in renewable energy as a structural solution to dependence on volatile fossil fuel markets. The government had all of these options available and reached for very few of them, and those it did use were limited in scope and riddled with loopholes.

Where corporate profiteering contributes to price rises, stronger competition regulation and excess profit taxes represent both more targeted and more effective responses than broad monetary tightening. A bank earning exceptional returns from rising rates while failing to pass those rates on to ordinary savers is profiteering, and should be taxed accordingly rather than rewarded for it.

On the longer-term management of inflation, the MMT-informed position I hold points to the importance of maintaining adequate real productive capacity. An economy chronically underfunded in its public services, its housing stock, its energy infrastructure, and its workforce development will be more vulnerable to inflationary pressure precisely because its productive capacity is lower than it should be. The solution to that vulnerability is investment in expanding what the economy can produce, not keeping interest rates high and growth suppressed in the hope of keeping price indices where an arbitrary target says they should be.

Conclusions

Across all of this, I maintain that inflation policy must be assessed against its distributional consequences, not merely against an aggregate price index.

Who gains from inflation? Who suffers from it? Who gains from the policy response, and who suffers from that?

These are political questions, not technical ones, and the pretence that they are otherwise is itself a political act.

The post-2022 tightening cycle, as I have argued at length, worked primarily to protect financial asset holders while imposing its costs on working households, renters, and the services they depend on. Understanding why that choice was made, and in whose interests, is central to the kind of political economy I have spent my career trying to build.

Reading List

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Post Date What it covers

Central banks failed on inflation 20 May 2026 Examines why central banks' interest rate rises did not cause inflation to fall; supply shocks did

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The UK's inflation data has been seriously overstated 30 April 2025 Discusses

how ONS methodology using list rather than actual prices inflated the recorded inflation rate

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***What do you do when the target's wrong?* 17 October 2025 Questions the Bank of England's continued hawkishness when the 2% target itself may be the problem**

***Why 2% inflation?* 23 October 2025 Argues the 2% inflation target has no credible theoretical basis and was invented for political convenience**

***Does taxing the wealthy control inflation?* 18 November 2025 Explores the MMT argument that taxation on those with high incomes is a better anti-inflation tool than rate rises**

***MMT questions* 21 December 2025 Addresses reader questions on MMT's approach to inflation and the role of taxation in managing demand**

***A 3% inflation target would work just as well as a 2% one* 18 April 2024 Argues that targeting 3% rather than 2% would have avoided much of the damage from post-2022 rate rises**

***The Bank of England used the inflation crisis to boost the wealth of the wealthy, but did nothing at all to control inflation* 10 May 2024 Shows using IMF data that inflation was caused by shocks that would have resolved without rate rises; the rises transferred wealth upward**

***The Bank of England has been fuelling inflation by boosting the incomes of older, wealthier, Tory supporters* 5 January 2024 Uses Resolution Foundation data to show how interest rate rises transferred income to savers and fuelled further inflation**

***The Bank of England knew inflation was going to rise now – in February* 18 December 2024 Demonstrates that the Bank's own forecasts showed inflation would tick up temporarily; there was no case for rate alarm**

***Greedflation is alive and well in UK boardrooms* 22 August 2023 FTSE 100 executive pay data undermines the Bank of England's denial that corporate**

profiteering contributed to inflation

***The way to cure inflation is to cut the Bank of England base interest rate* 21 June 2023 Argues that rate rises were the wrong tool for supply-shock inflation and that cuts would have helped, not hindered**

***The risk of the Bank of England massively overshooting on inflation is high* 4 August 2023 Warns that the time-lag in monetary policy meant rate rises would land after inflation had already resolved**

***Inflation is falling – but not thanks to the Bank of England or government policy* 15 February 2023 Explains how the statistical construction of annual inflation indices meant the fall was automatic, not policy-driven**

***Why is UK inflation not falling as fast as it is in Europe?* 19 April 2023 Identifies rigid energy pricing and the consequences of Brexit as reasons UK inflation was slower to fall than in Europe**

***Can public sector pay rises cause inflation?* 14 April 2023 Explains why public sector wage increases cannot be the cause of inflation when supply-shock factors are responsible**

***Who has caused inflation in the UK?* 3 February 2023 Identifies oil companies and banks as the primary culprits of inflationary profiteering during the 2022–2023 episode**

***When will we get price controls to limit inflation?* 24 May 2023 Asks why, with supply chains restored, prices remain high, and calls for price controls to limit greedflation**

***The inflation we are suffering is by government choice* 18 May 2022 Early analysis identifying how government inaction on energy pricing and windfall profits allowed inflation to take hold**

***We need a proper windfall profits tax* 31 August 2022 Calls for a robust windfall profits tax on energy companies and banks benefiting from the inflationary crisis**

***Why the UK's 2% inflation target is wrong* 9 May 2018 Foundational post arguing the 2% target is technically unsound and reinforces inequality**

About me

I am a political economist, emeritus professor of accounting practice at Sheffield University Management School, a former professor of international political economy and, for 42 years, a practising chartered accountant.

As a tax justice campaigner, I created country-by-country reporting which is now legally required for multinational corporations' tax reporting in more than 70 countries around the world to tackle tax haven abuse.

I am one of the UK's most widely read heterodox economics bloggers as the author of the Funding the Future blog and presenter of the Richard J Murphy YouTube channel, which has more than 380,000 subscribers.

I co-founded the Tax Justice Network, Fair Tax Mark and the Green New Deal.

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