

Will the Bank of England crash the economy?

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The Bank of England has held interest rates at 3.75%, but three members of its Monetary Policy Committee wanted an immediate increase. With inflation rising again, the threat of higher interest rates is very real, and the Bank say they may well raise rates soon.

But would raising interest rates actually tackle the inflation we now face?

The problem is that much of this inflation is being driven by disrupted energy supplies, food pressures and geopolitical instability. These are supply-side problems. Higher interest rates cannot produce more oil, gas, electricity or food. They can only reduce demand by making households and businesses poorer.

In this video, I explain why I think the Bank of England is using the wrong economic tool for the problem we face. Higher rates increase mortgage costs, put pressure on rents, discourage investment and can increase unemployment. At the same time, they increase returns for many owners of financial wealth.

I argue that the appropriate response to supply-driven inflation is very different. We need investment in energy security and food resilience, targeted fiscal support for those hardest hit by rising prices, and lower interest rates to reduce unnecessary pressure on households and investment.

Monetary and fiscal policy should work together to maintain economic and social stability. Instead, we risk having one foot on the accelerator and another firmly on the brake.

<https://www.youtube.com/watch?v=J1YYo-C498E?si=zu3LObVCFB-LdOGY>

This is the audio version:

https://www.podbean.com/player-v2/?i=qmqmvz-1b608f8-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

There is no debate ammunition for this video, but this previously published infographic supports it:

Why higher interest rates will not solve this inflation

① The ECB has raised interest rates

- The European Central Bank sets interest rates for countries that use the euro.
- It has raised its base interest rate to 2.5%. The Bank of England is likely to follow.
- The ECB says this will help control inflation following the war between the USA and Iran.
- War and drought have disrupted supplies of energy and food. Those shortages are driving inflation.



② But this inflation has the wrong cause

- Interest rate rises can only address inflation caused by excess demand, when spending is greater than the economy can supply.
- No one is suggesting that is happening now in the Eurozone or the UK.
- This inflation is caused by shortages of real resources.
- Making money more expensive cannot replace missing energy or food. Higher interest rates cannot solve this inflation.



③ A metaphor explains why

- Imagine a household whose water supply has fallen because its supply pipe is leaking or partly blocked.
- The household has not suddenly started using more water.
- There is simply too little getting through.
- The problem is the supply, not the demand.



④ What should the water company do?

- The obvious answer is to repair the pipe.
- Instead, suppose the water company increases the price of water.
- The household still receives too little water.
- But now it also must pay more for what it receives.



⑤ The water company is protected

- The water company was losing revenue and profits because it was supplying less water.
- Increasing the price restores its financial position.
- The company is protected.
- But nothing has been done to solve the household's problem.



⑥ The central bank is the water company

- The disrupted supply of energy and food is the leaking pipe.
- The economy, and the people living in it, is the household suffering the shortage.
- The central bank increases the price of money rather than addressing the shortage.
- The economic pipe remains broken.



⑦ Who gains and who loses?

- Higher interest rates increase returns to owners of financial wealth.
- Those dependent on wages are discouraged from seeking pay rises to maintain their living standards.
- The shortage remains unresolved.
- The central bank policy shifts cost onto those least able to bear it while protecting those with wealth.



⑧ Fix the economic pipe

- Raising interest rates in response to supply shortages is a policy failure.
- Central banks cannot create the energy or food that is missing.
- Government must tackle the shortages by investing in alternative energy and food supplies.
- Lower interest rates would make that investment easier and cheaper.
- Meanwhile, inflation should be allowed to work through as supply is restored.
- Government must solve the problem, not punish those already suffering from it.



Conclusion
Fix the pipe, don't raise the price

If a leaking pipe causes a water shortage, increasing the price of water does not repair it. Supply-driven inflation is the same. Raising the price of money cannot create missing energy or food. The answer is to repair the supply.

funding the future

<https://www.taxresearch.org.uk/Blog/>

Richard Murphy's
Funding the Future blog

This is the transcript:

The Bank of England made a serious mistake yesterday. It didn't raise interest rates, we have to give it credit for that. But at the same time it warned that it will have to do so following the example set by other central banks. They say they will have to do so to tackle rising inflation.

But let's be clear: it is disrupted energy supplies, food shortages, and drought that are driving this inflation. There is no excess demand problem to solve in our country at present, and it is only inflation caused by excess demand that an interest rate rise can ever address.

That is the serious mistake in understanding that the Bank of England revealed in its thinking yesterday. Most especially higher interest rates cannot create more energy or food, so they cannot solve any known economic problem.

And let's be clear: the inflation we are witnessing right now is supply-driven. It reflects shortages of essential real resources. Energy, food, and supply chain disruptions are its causes. Demand is not excessive. In fact, for millions of households in the UK, it is already inadequate. They do not have enough to spend because they are suffering a cost of living crisis. To pretend that they are driving up inflation as a result is quite absurd. As a consequence, this interest rate rise addresses none of the issues implicit in the situation that we are facing in our economy at this moment.

Let me use a metaphor to explain how wrong the Bank of England's actions are. Imagine the water supply to your house has a blockage or leak in it. Your house is receiving less water than it needs because the supply pipe is failing. Now, I stress you're not paying for that water, but you still have a problem. You haven't got enough water in your household. That's a supply-side problem.

The obvious solution is to repair the pipe. Instead, the water company increases the price of water to you to maintain its income and profits, even though you have less water than you need. You will pay more as a result. But the shortage remains. Nothing is fixed.

This is precisely what the Bank of England is doing. The economy has shortages of energy and food. The Bank has responded by increasing the price of money. Doing that does nothing to increase the supply of either energy or food. It just protects financial interests while making everyone else's problems worse, and the economy very much weaker. The Bank of England actually knows that, and the most staggering thing is that it is doing this anyway.

So, how should we describe this action on its part? We could call it economic illiteracy, except they know what they're doing. In that case, the only other description I could think of is class warfare, not a phrase I use very often, but which in this situation seems to be entirely appropriate.

Workers are being explicitly discouraged from seeking pay rises to protect their living standards because this policy will deliberately increase unemployment. And meanwhile, households will face increased living costs, and borrowers will face higher mortgage costs, and those in rental accommodation will see higher rents. And that will all be because of higher interest rates.

And at the same time, those already making excess profits from shortages, and we know that oil companies already are, will be left entirely untouched by this interest rate change. In fact, they may be better off because they, along with the wealthy, will be earning more interest as a result. The owners of financial wealth are then being protected, while working people will pay the price. That's why I think this is class warfare.

So what should have happened? The real causes of inflation should have been addressed. The supply disruptions driving this inflation are geopolitical in origin. No interest rate change created by the Bank of England can resolve a war in the Middle East. But government investment in alternative energy and food supplies could have been made now as a matter of urgency to solve those real underlying problems in our economy. The only problem is that those investments will now be more unaffordable because of increased interest costs.

What we need is more investment in our economy. And the Bank of England has just made that very much harder with a decision that looks even more incomprehensible as a consequence.

And what we also need is a joined-up economic policy. At present, we have the Bank of England running monetary policy and the Treasury running fiscal policy in this country. Monetary policy, with a threatened increase in interest rates, is trying to put a very hard brake on our economy at present. It is trying to create a recession, and more unemployment, and reduced demand. At the same time, the government has promised a better standard of living. It's trying to boost the economy. The consequence is that we're running economic policy with one foot on the brake and one on the accelerator, and we will be going round in circles as a consequence.

The government should end this farce. It should take control at this moment. The Bank of England's independence has to be suspended. We are facing a crisis. The government should say we are going to have to go through an economic transition where it looks likely that food and energy costs are going to rise, and it must reduce costs elsewhere as a result. What is the obvious cost it can reduce? That is the interest rate.

Doing that, it could solve the supply-driven inflation that we are facing. And history shows that these supply-driven inflation shocks do always pass over time, where time is usually a period of less than two years. And in that meantime, the government could announce that it will intervene, and provide price support, and tackle shortages and try to help those who are in real need as a consequence of that inflation. That is within its fiscal power, and it can afford to do it. Doing so will in fact be much cheaper than letting interest rates rise. So, reassurance and targeted action from the government are required, and not deliberately imposed economic pain.

So, that's what should have happened, and what would that look like if it had happened? Well, interest rates should have been cut. They are the wrong instrument

for this problem. And cutting them would have, in fact, helped boost the economy at a time when it is going to be suffering stress already. That's the consequence of these prices working through the system. So cutting rates would've rebalanced people's ability to afford what is going on. Instead, everything is going to be made harder.

Fiscal policy should have been used to protect those who are hardest hit by rising prices.

And the government should have announced investment in domestic energy security and food resilience.

And why do this? That's because the central banks must serve economic and social stability , and not financial markets. Raising rates solves none of the causes of this inflation, and using them as a political choice is the wrong one.

That's what I think. What do you think? There's a poll down below. Let us have your opinions. Please like and share this video. Please do also subscribe to our channel and hit that bell, so you will be notified when we produce a new video. And if you'd like to donate to the channel, there is a link to do that down below, and we'll be very grateful.

Poll

[poll id="529"]