

A tale of our inflationary times

Once upon a time there were three little Central piggy banks. Or to be more accurate, at three very different times three little Central piggy banks were set up. First came the smallest one, the Bank of England. There was next the biggest, the Federal Reserve Board. Much later there was the youngest one, the European Central Bank.

They all had misleading names. The Bank of England is the Bank of the UK, not just England. It went in for understatement or historical lethargy about its name. The Federal Reserve Board is the Central bank for the whole USA. It has kept its old name too as a memory of how the dollar helped drive integration of the states of the Union through its federal approach. The European Central Bank is not the Central Bank for Europe but just for some countries that joined. It launched with glorious overstatement.

By 2000 the three Central piggy banks thought alike and started to hot things up. They all asserted they were very important and independent. They denied that the states who owned them and who appointed their top people had any influence over what they did. Armed with this moral right and their cleverness they allowed a massive bubble in credit, fancy derivatives and bank lending. By 2007/8 it was so extreme they decided to stop it. In doing so it caused a Great Depression. There was the noise of a large banking crash.

The governments were not very happy about this. Several of them were criticised by angry electors who blamed them rather than the banks. So the banks and the governments got together and blamed everyone else in finance apart from themselves. Electors threw out the governments anyway. The top people in the three little piggy banks kept their high salaries and important jobs.

The three little piggy banks reckoned they needed to try something new as the public might get cross with them as well as just sacking the governments. So they decided to make themselves very popular by printing lots of money and driving down interest rates. All they had to do was create a big figure in an account and then go out and spend it. And so they did. They were not very imaginative shoppers. They decided to spend all their newly made money on buying up government bonds. This meant all those who owned these bonds got richer as the prices went up, and some had lots of money to spend when they sold their bonds to the banks.

The big bad Inflation Wolf stood outside the doors of the little piggy banks. These were wise piggy banks who had learned from the old story of the three little pigs. All their banks were built of stone or steel so they did not fear the Inflation Wolf. They told him he could not blow them down.

A small number of monetarists told the piggy banks if they printed lots of extra money there would in the end be a big inflation. The banks ignored them

They got away with the money printing for a bit. They were lucky because the commercial banks were all so damaged by the banking crash and by new rules stopping them lending so much, money stayed under reasonable control despite the printing. Even the monetarists were not alarmed either all the time money did not grow too much. The wolf got fed up with waiting.

When there was a new disease spreading fast around the world governments decided to lock down large parts of their economies and order people to stay indoors. Once again the little piggy banks cranked up their printing presses. The governments were so grateful as it meant they could borrow billions to give to people so they had some money when they could not work. Everyone agreed this would not be inflationary.

Unfortunately as the economies were unlocked and recovered quickly the little piggy banks kept on printing. Why stop now they asked? it makes us popular. There is still no inflation. The monetarists stirred and pointed out that now there would be a big inflation because the new money was leading to lots more money around . The little piggy banks thought they were silly and carried on printing and buying up bonds at ever higher prices.

The bad old inflation wolf had learned a few tricks compared to his ancestor who had landed up on the fire by going down the chimney of the third little pig's brick house. He saw that whilst the little central piggy banks all had strong steel or stone buildings, they had very weak finances. They were buying many times as much in bonds as they had capital. If as he thought they started to lose money on all those very dear bonds, what would happen then?

And so it proved. A great inflation took hold just as the monetarists had warned and the wolf had hoped. The little piggy banks decided they had to do something about it, as suddenly they were no longer popular . People had believed them when they said they knew what they were doing and there would be no inflation. So they did what they do best. They blamed the big inflation on a nasty war though prices had been surging well before it started. Then they decided to create a recession to make things cheaper

again. This meant they would lose huge sums on all those bonds they had bought.

The wolf licked his lips about all those losses. They were going to run out of money and have to leave their strong buildings. In each case the losses would amount to far more than the capital the banks had. If they were normal businesses they would go under. But said the little piggy Central Banks, we are not normal. We do not have to worry about losses. The Bank of England had a good answer to the wolf. They had a guarantee that all their losses would be paid by the taxpayers, so they were financially secure. The Fed said we can just create more dollars. The world needs our dollars so we will just ignore all the losses and print what it takes to pay our salaries. You will not get us Mr Wolf. Which left the European Bank at a bit more of a loss. So they said most of their losses would be sent to the member state national banks, sparing the European Bank the problem. If the member state banks ran out of money they would need to get it from their governments.

Mr Wolf is dismayed outside the three little piggy central banks. It looks as if they are cleverer than him after all, just as the third little pig outwitted the original Mr Wolf all those years ago. The little Central piggy banks will live on, with the taxpayers having to pay colossal bills for their latest mistakes.