Article for the Independent on the Bank of England

The debate over mortgage rates and the high rate of inflation is made difficult by the general view that the Bank of England is independent. This discourages politicians and media from debating their actions and thoughts, and impedes government action.

Constitutionally this is incorrect. The Bank does have the independent power to fix Bank rate following consideration by its Monetary Policy Committee. It is set a target of getting inflation to around 2% a year, a target last revised by Gordon Brown who changed it. I am not proposing they should lose that power. Otherwise it is deeply involved with the government.

The Bank is 100% owned by the state. The government of the day chooses the Governor. The Governor reports to the Treasury Committee of both Houses of Parliament, where he is subject to scrutiny over the work of the Bank. The government bails it out if it loses too much.

The main agent of monetary policy since 2008 has been the Bank both greatly increasing its balance sheet then contracting it. As it expands it buys bonds at ever higher prices, driving interest rates down. As it contracts it sells bonds at losses driving rates higher . The Bank's decision to make a large sale of bonds just before the Kwarteng budget along with the rate rise pushed bond prices down. This was compounded by the difficulties of LDI funds owned by pension funds having to sell to cover the calls as the market fell. The Bank's decision to reverse the sales policy and buy some bonds again rallied the markets, showing how much control the Bank has over it.

This policy is a dual control policy. The Chancellor signs off on the bond programmes. The Treasury provides a full guarantee to the Bank against losses on the bonds. The Bank says it acts as an Agent of the Treasury when doing this.

The Bank overdid the bond buying in 2021. I supported its £300 bn to see us through lockdowns but thought the subsequent additional £150bn was risky, likely to bring on inflation. Clearly the bond buying created an asset price inflation, boosting bond prices and in turn shares and properties as the people and firms who sold the bonds to the Bank reinvested their money. In due course money got into wider circulation, and the money the government gave to people and companies based on ultra cheap state borrowing also helped stoke inflation.

Supply was constrained by the after effects of lockdown, by changes in the labour market and by world disruptions brought on by the Ukraine war. Too much money was soon chasing too few goods, scarce energy and food. An inflation set in, leading understandably to people wanting pay rises to limit the damage to their spending power.

The Bank has now said it will review how it forecasts inflation and how it runs its models and makes its decisions on rates. That is a necessary task, as its models gave very wrong indications saying inflation would stay at 2% and then saying higher inflation would be transitory.

The Bank also needs to take an interest in money and credit. It needs to look at the way expanding its balance sheet is inflationary and contracting it too fast may produce a recession. It should ask itself why China has inflation of 0.2% , Switzerland 2.2% and Japan 2.7% when they all import substantial amounts of energy. Their Central Banks followed different policies when dealing with covid and Ukraine.