

# Inflation, money policy and wages

Yesterday came the expected good news that headline inflation is below the 2% target. Core inflation has been below target since June 2018. Meanwhile wage growth is around 3%, so real wages are now rising. People can look forward to having more to spend as their pay goes up.

The Bank of England has been changing its mind about all this. In a past good lecture the Governor argued that there is no longer a simple trade off between lower unemployment and higher inflation. The so called Phillips curve suggested that if unemployment fell wages started to go up faster, leading to price inflation and the need for the authorities to rein things in. Revision to this pointed out that in a modern open trading economy like the UK prices are held down by global competition, and wages by inflows of migrants and by importing labour intensive goods and services from lower wage countries. In his most recent speech the Governor has rowed back a bit on this sensible observation. He claims that there is once again a modest trade off between lower unemployment and higher wages, and that therefore the Bank will need to tighten further to control prices in the months ahead.

I do not agree. It is true wages have been going up faster in the last year, but there is no evidence this is flowing through to prices which remain under the cosh of global competition. In part wages have gone up through the introduction of the Living Wage, in part through cost push pressures in areas of the economy like care homes where recruitment has been difficult. The danger is lifting interest rates too far too fast will plunge us into a downturn. There is too little money and credit about as it is, given the Bank's tightening policy. The Governor does at least acknowledged that he has deliberately tightened policy over the last year.

It is time he said job done. The Fed has been more magnanimous in saying they have tightened enough. The Bank of England should also say this more clearly, and work to ensure a decent supply of credit to households and businesses. As The Governor argued convincingly there is no debt problem in either the public or banking sectors in the UK. With China slowing and the Eurozone stalling we need a positive policy in the UK. With inflation under target now is a good time to promote growth and allow people to buy more cars and invest more in property and business.

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## More new shops for Wokingham centre

I was pleased to hear the news that Cook, The Blue Orchid Bakery and Tearoom, the record and music shop Beyond the download, Sit and Sip a craft beer company and the leafy Elephant gin bar are all signing up for the new central Wokingham development.

They are all very welcome and will add variety and interest to Wokingham's offer of shopping, food and drink. They will help attract more people to the new town centre, and will add to the enjoyment of visits.

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## The Bank of England forecasts a modestly faster rate of growth for 2021-22

The latest Inflation Report from the Bank expects UK growth to improve in the second half of its three year forecast period from now, reaching a bit above 2% after a period at lower levels. The Bank thinks supply and demand is currently in balance in the UK economy, that it will slow a bit this year leading to a small amount of surplus capacity, followed by a tightening.

As the Governor himself has explained in a past lecture, this concept of domestic capacity has its limitations as a way of estimating what will happen next to prices. Given the open nature of the UK economy, capable of importing goods and services from around the world that are in short supply at home, a lack of capacity does not automatically translate into higher prices. Given the enthusiasm of UK companies to welcome employees from overseas there is also a countervailing pressure on wages as the local jobs market tightens up through substantial job creation. Despite this the Bank thinks it will need to toughen monetary policy as they approach the second half of the forecast period, which will in itself slow things a bit.

The Bank's figures show that the UK this decade has grown faster than the Eurozone, and the Bank sees the sharp slowdown in Eurozone growth in the second half of last year as a factor slowing our economy. They recognise that the bigger slowdown in residential property prices in London resulted from being "disproportionately affected by regulatory and tax changes" often commented on here. The buy to let and Stamp Duty tax changes hit turnover and prices of the expensive London properties. They see a modest slowdown in the world economy as a whole, and do not see any major inflationary threat in global markets.

They mention Brexit frequently, saying they might respond either way depending on when and how it occurs. There is no sign of a recession in either their world or their UK forecast, though they acknowledge the recessions now stalking some of the continental countries. It would be good to have more analysis of why this is happening in the Euro area and what knock on effects it will have on our exporters. They remind us that the European single currency area accounts for 38% of our current exports. Presumably the slowdown or recessions in continental countries could mean some favourable downward pressure on our import prices, where we import many

more goods and food than we export to them.

The UK economy has held up well at a time of negative growth in Italy and Germany and slowdown in France. This has happened against a background of UK policies that have led to a large reduction in new car sales, and a slowdown in housing transactions. Buy to let investment by individuals has been reduced substantially by tax rises, and new car sales hit by policies against diesels along with higher VED particularly for dearer cars.

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## The world economic slowdown

The Central Banks of the USA, Euro area, UK and China have all been slowing the economies they regulate. The US economy has done the best, as the Fed has allowed substantial credit growth in the private sector to offset some of the impact of rate rises and the reduction of Quantitative easing money and repayment of bonds. As a result the US economy which started to grow at more than 3% may manage more than 2% this year. The impact of the tax cuts and fiscal stimulus administered by the government is helping.

The Bank of England has been the toughest, cutting money growth considerably, reining in car loans and consumer credit, putting through two rate rises and ceasing all Quantitative Easing. The European Central Bank has been the softest, continuing with large amounts of money creation and bond buying up to the end of last year, and flagging no rate rises for the foreseeable future. Their current interest rate of 0% is lenient.

Despite this the Euro area economy is slowing the most. Italy is in recession, reporting reductions in output in both the third and fourth quarters last year. Germany had a down quarter in the autumn and may have had another down quarter to December 31. Greek and Cypriot output remains miles below the 2007 levels, with Italian GDP also still lower than pre crisis in real terms. French growth is slowing markedly and the whole Eurozone is back in stagnation. The UK is managing slower growth, which shows underlying strength given the squeeze being administered by both the Bank and the Treasury.

China has seen a small slowdown in growth on the official figures, with reports of a sharper slowdown for manufacturing and imports. Chinese money policy has also been more restrictive than in the past, with the authorities now signalling they wish to relax a bit to avoid more damage to growth.

It is difficult to see what the Eurozone can and will do to lift things. It is a poor background for the traditional parties fighting the European elections in May, but it is the result of the disciplines of the Eurozone. All the time the Germans and the other richer surplus countries decline to send more grants and cash to the poorer parts, it reinforces the need to squeeze budgets to keep finances in control. This in turn leads to slower or

no growth, which in turn means less tax revenue and a bigger budget squeeze.

The Euro, just like the Exchange Rate Mechanism it replaced, is a recession machine for the weaker economies. That is why the Italian government tried to get a different budget, and one of the reasons why populist parties around the continent are making progress electorally.

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## Brexit end game?

As we listen to the ticking clock we are assured by the PM we will leave on 29 March this year. The question remains how.

It sounds from the government line and the line of Mrs May's helpers that they want to get Parliament to reconsider the Withdrawal Agreement which Remainers and Leavers united to defeat. They seem to think they can pose Remain MPs with the choice of no deal versus the Agreement where they might prefer the Agreement, whilst saying to Leave MPs it is Withdrawal Agreement versus No Brexit. The problem with this approach, as tried last time, is it is contradictory. The threat of No Deal issued to Remain supporters is exactly what many Leave voters now want.

It is not credible to say to Leave MPs Brexit will be cancelled if the Withdrawal Agreement is rejected again. The government would have to propose rescinding the Article 50 letter and embark on the repeal of the EU Withdrawal Act. Many MPs would realise this would destroy the trust of electors. It would lead to the loss of many seats as Labour and Conservative MPs who had won in 2017 on a clear promise to implement Brexit faced retribution from angry voters at the following election. It is difficult to see how Mrs May's leadership would survive any such attempted U turn on such an important issue, and questionable whether DUP support for the government could last either. There is every reason for MPs to stay loyal to the Conservative or Labour Manifesto and refuse to repeal the legislation.

To a Leave MP the Withdrawal Agreement was easy to vote against because it is not leaving. It is a further 21 to 45 months in the EU, accepting their new laws without any say on them, under their court, and paying large unspecified sums to their budget. With the backstop it might keep us in a customs union permanently. The Conservative Manifesto very clearly promised we would leave the EU, single market and Customs Union. The Labour Manifesto promised to leave the EU and set out a detailed trade policy that would be incompatible with Customs Union membership.

Mrs May might late in the day get some legal text offering reassurances about the backstop. It is unlikely to be a full rewrite of the Agreement taking the backstop out in the way Parliament requested through the Brady amendment. This should not be enough to lead to the successful passing of a motion in favour of the Agreement after all, and certainly not enough to give the

government a majority for the complex legislation it will take to put the 585 page agreement into UK law. I see no way of avoiding a full debate on the complete agreement, whatever the draft Withdrawal Agreement Bill might say, allowing plenty of opportunity for doubts to be expressed about many features of this comprehensive lock up of UK sovereignty under a new and damaging EU Treaty.

Given this Remain may well seek delay instead. The issues this poses are two fold. Why would the EU consent to 3 to 9 months delay, given their view that the negotiations are over and the Agreement cannot be re opened? How would this fit in with their timetable for European elections and a new Commission? Why would they want to prolong the exit of a country that is clearly going to leave and is refusing their expensive terms for an extension of membership?

Worse still is why would the UK want delay? It prolongs business uncertainty. It makes the UK look feeble and indecisive. It delays new trade deals and stops us spending the money saved on exit. It fails to take back control of our laws, our money and our borders.

I do not see how there are things we can get the EU to agree in April and May that we cannot get them to agree in February and March against the pressure of the deadline of our departure. The public want government and Parliament to just get on with it. That is also the best negotiating strategy. I still want a managed WTO exit with a UK offer of a free trade agreement which could avoid tariffs and other new barriers to our EU trade.