

The Bank of England writes another letter

The establishment states that the Bank of England is independent and is responsible for keeping inflation around 2%. The authors of this relationship did foresee the possibility that the Bank would fail to achieve its single objective. Their remedy was to make the Bank write a letter to the Chancellor, who in turn was empowered to write back. We have just seen another example of the letter writing arts of the two parties. The constitutional position has in fact been that the key decisions of how much money to create and how many bonds to buy, the main drivers of Bank policy in the last 13 years, have been joint ones requiring Treasury sign off.

When you get to letter writing stage it is clear the Chancellor becomes part of the decision process, with the formal opportunity given by way of public letter to criticise, influence, support or reprimand. So far these letter exchanges usually show the Bank offering some excuses for failure to keep inflation down and saying something vague about how they might remedy it going forward. The Chancellor often agrees whilst placing more accent on the excuses or more emphasis on the need for future action depending on what he wants next. No-one can read these exchanges and seriously say the Bank is completely independent. They must accept the ability of the Chancellor to write a public letter invites him or her to influence analysis and policy at a time when the Bank has clearly failed to carry out its single task. If some other Governor in the future had wantonly failed to curb inflation the letter could be the last straw presumably leading to replacement of the poor performing Governor. The government after all owns the Central Bank and appoints its boss.

So what should we make of the latest round of letters? I was disappointed but not surprised that neither side mentioned the fact that they had jointly agreed to create so much money and to go on buying up bonds for so long. That might have affected inflation. Neither side mentioned the rapid rate of money growth during the intense Quantitative easing period or thought that might matter. Neither side made any forecast of what might happen to credit and lending from here or what role the large savings balances of the better off part of the population might play going forward. No-one asked why Bank and OBR forecasts of inflation have been so hopeless.

Both accepted that the obvious large price rises in energy and food played a part more recently following the Russian invasion of Ukraine. Neither asked why China and Japan, large importers of fossil fuels themselves, still have inflation around 2%.

The inflation was mainly fuelled by last year's policies. This year policy is much tighter, and the Bank itself expects inflation to come down next year. If in the next few weeks inflation does not embed and inflation expectations do not climb, the economic policymakers will need to address a shift from too hot an economy to potentially too much of a slowdown.