Central Banks lurch from inflationary policy to banking squeeze

Readers of this site will know I was critical of the Bank of England, Federal Reserve Board in the USA and the EU's ECB for continuing money printing in 2021 well into recovery. Coupled with interest rates at zero it was bound to be very inflationary. So it proved. China and Japan did not do this and kept inflation down to around 2% despite importing a lot of dear energy.

They will also know that last year whilst agreeing with rises in rates I warned against Quantitative tightening, selling government bonds at ever larger losses to tighten money yet more. It was this policy announced by the Bank of England just before the Kwarteng mini budget that drove bonds down. The Bank of England had to reverse its policy the following week and buy up some bonds to restore stability. They showed they controlled the prices of the bonds, letting them fall too far then rallying them sharply. It was the impact of the falling bonds on pension funds including the Bank's own that spooked them.

I also thought the Fed was overdoing the bond sales. Last week two US banks collapsed, and a third sought substantial financial help. The share prices of a few US banks show investors are worrying about them. Losses on government bonds were part of the problem at Silicon Valley Bank when it went down.The Fed had to announce a large line of credit for banks generally and pump liquidity into the markets to avoid further bank runs, reversing some of the excessive tightness of money brought on by bond sales. Just like the Bank of England with its pensions problems.

The ECB has only just started Quantitative tightening and says it has no bank troubles in its area. Credit Suisse was just over the border and said to be a one off. Nonetheless a few EU commercial banks have suffered sharp falls in share prices over the last week so the ECB should not be complacent. The main UK banks were much strengthened after 2009 and are not being fingered in the markets.

So why do these Central banks lurch from obviously inflationary policies to clearly over tight ones that threaten pension funds or banks in their areas? They ignore the growth rates of money and credit, failing to see that too much money usually brings on inflation and too little brings company and weak bank collapses.

The Central banks now share a dilemma. Carry on tightening and they could cause another crash. Relax too much and they could reignite inflation. That is why they should aim for a steady moderate increase in money and credit to avoid inflationary and deflationary shocks. The Bank of England should not carry on selling bonds at big losses. Commercial banks will now be tougher over new loans given the fears that stalk the markets.

The ECB which was very slow to try to curb the inflation it had encouraged needs to learn from the Bank of England’s bitter experience with the pension funds and from the USA losing a couple of banks.