

The Fed rethinks – what about the Bank of England



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The Fed realised late last year it was raising rates too much and tightening the money supply too severely. It backed off and announced a re think. It is currently working its way through how it can change its approach and make it friendlier to economic growth.

The Bank of England needs to do the same., It has been tightening too much for the last two years. Like the Fed, it relies on out of date theory based around the concept of national capacity. It thinks it knows what national capacity is, and argues that there will be inflation when we reach close to that capacity. For an open economy like the UK it is an odd way of thinking about it. We import goods and services and we import labour so our capacity is not constrained by UK resources, whilst world products, services and labour keep prices and wages down as a result of global competitive pressures.

The Bank seems to want to prove a point about its errant pessimistic forecasts over Brexit. It should listen to what the Fed is saying, and back off from its current over tightening. The UK economy needs a bit more Bank flexibility at a time of slowing world growth and little inflationary pressure. They need to revise their views on how to settle interest rates, in line with the Governor's lecture explaining how the Phillips curve was now flat . Given this there is little need to raise rates as unemployment falls unless there are other signs of overheating or too much credit.