A recession is worse than inflation – why the Bank is getting this all wrong

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INFLATION hit 9% in April but this may well be close to the peak. Inflation falls as people stop spending but the fix to getting prices down is likely more harmful. The combination of fiscal austerity and monetary tightening is likely to put the economy into a downward tailspin. Brexit hasn't helped.

Recessions hurt more than inflation. A one percentage point rise in the unemployment rate, say from 4% to 5% in well being terms, hurts at least five times more than a one percentage point rise in inflation. A rise in unemployment hurts the unemployed but also lowers everyone else's well-being as they have friends and family who are unemployed, college graduates have trouble finding good jobs and workers fear they will lose their jobs. The fear of unemployment hurts a lot.

Attempts to 'solve' the inflation problem through monetary tightening are likely to produce something more painful. A deeper, longer lasting recession than happened in 2008/9 where output fell 6% over five quarters is increasingly plausible. The OECD is already forecasting that growth in the UK in 2023 will be the next to slowest in the G20 after Russia and the reality may well be nastier.

Consumer confidence has now hit its lowest level since 1974 and is predictive of a recession. GDP fell in April and March and was negative in December 2021 zero in February and negative again in March and April. Such numbers may well end up being revised down as this is what occurs at turning points down and is what happened in France where their first quarter estimate for GDP was recently revised down from zero to negative.

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The lack of credibility of the MPC at the Bank of England which are responsible for economic policy is currently a major problem. In the most recent Inflation Attitudes Survey conducted by the Bank, only a quarter of respondents said they were satisfied with the Bank's performance- the lowest since the survey started in May 2009.

Since July 2003 the Bank of England has had three Governors Mervyn King, 2003-2013 (0), Mark Carney, 2013-2020 (8) and Andrew Bailey, 2020- (1). In parentheses I score them out of ten. King has to score zero. He missed the Great Recession and had no idea even by October 2008 that the UK had entered recession six months earlier. King didn't think it was necessary to monitor closely what happened in banks like Northern Rock where thousands lined up outside the bank branches to withdraw their savings. The previous UK bank run before Northern Rock was in 1866 of Overend Gurney, a London bank. King also failed to spot the catastrophic failures of RBS and Lloyds that nearly brought the global financial system down.

Carney did pretty well and scores eight although his forward guidance policy didn't work that well but there were no disasters on his watch. He clearly was highly qualified and had lots of other alternative high paid options he could have taken having previously been Governor of the Bank of Canada. Carney always made me feel like a professional was in charge, so he gets an eight with a bullet. Very good: could have done better but worth every penny. Unlike the other two.

Bailey, an insider who joined the Bank in 1985, has been hopeless but not quite as bad as King. His communication skills have been astonishingly bad. First there was going to be a rate rise and then there wasn't and then there wasn't going to be one and there was. Then the out-of-touch Governor who makes half a million quid a year told workers they should take real pay cuts. Oh dear.

Since the rate rise to 5.75% in July 2007 that I voted for, there were 158 MPC meetings with no rate rise for a decade. Since then, there have only been six increases – in November 2017, August 2018 as well as four rises in the last four meetings, one of 15bp, three of 25bp. In my view all were in error. I would have voted against all four of the recent rises due to fears they would cause a nasty recession which seems to be what has happened. The MPC in part caused it by their actions.

With this recent burst of inflation Bailey and the rest of the MPC have communicated that another rise is coming again this week, but they are confounded by groupthink. They are stuck in a mindset form the 1970s, but the world has changed since then. Unions had lots of power and they don't again. Today inflation is mostly supply driven due to remaining bottlenecks after Covid and the Ukraine war. Raising rates has no impact on deliveries of wheat held up in Odesa.

In these highly uncertain times what is the use of a committee of nine if they all think the same? Where are the dissenting voices calling for calm and introspection? At the last meeting six voted for a 25bp increase while three crazily voted for

50bp rise (Haskel, Mann and Saunders); the committee even admitted these moves would create a recession. If they all think the same you might as well have a committee of one getting it wrong: at least it would be cheaper.

There are plausible arguments to sit pat and not raise rates at all, and watch the data come in as the economy seems to be grinding to a halt. Over these two decades, excluding the three governors there have been 32 MPC members who mostly have not distinguished themselves although the exceptions are Wadhwani, Buiter and Posen who were all external part-time members who dissented and were right; the rest were essentially irrelevant (maybe I get in?)

There is no need for a nine-member committee when they all think and vote the same being drawn from essentially the same backgrounds and experiences with all of them living in London. All were previously either bank insiders, civil servants, ex City folk or academic economists on leave.

Why not have representation from the rest of the country as they do in the Federal Reserve in the United States. We need people on the MPC who bring something different to the table. Carney did that.

As the economy slows there are going to be the inevitable scapegoats. Twenty-five years after the independence of the Bank of England was granted in 1997 it may well be time for a rethink.