Time to start talking about cutting interest rates

Vicky Pryce

We have just had two central banks, the Federal Reserve in the US and the Bank of England in the UK, keeping interest rates unchanged for the second time within a day of each other. And that comes a week after the ECB in the Eurozone did the same. That is good news as far as it goes. But in all three press conferences afterwards, the words remained relatively hawkish- inflation still too high in relation to the almost universal 2% target- and that the vigilance needed to be kept up. All suggested this was a pause, not necessarily the end of the upward hike. Certainly 'too soon to talk about rates starting to come down'. And even though they must be aware that the markets do not believe them, they all, having more or less indicated that the peak was near, talked of rates staying high, for longer than may have been expected earlier.

How much longer? And then, honestly, what for? Are we seriously suggesting that the medicine needs to be continuously applied at the same dose even if the patient starts to recover from that original illness ? And not worry about what that continued medication may do to the rest of the body and his/her long term survival?

It must be that the BoE believes that the medicine hasn't worked fully yet as some of the MPC rate setters argue that only 50% of the rise in interest rates has so far passed through the economy . Do we all still remember the first, tiny, 0.15% rise from near zero in December 2021, nearly 2 years ago leaving us nearly 2 years later with rates at 5.25%, the highest level in 15 years , following 14 successive increases before the pause in the last two MPC meetings?

When inflation looks like being tamed, surely you change your mind? Even though the new war in the Eastern Mediterranean has added new uncertainties. A case can be made that 3.7% inflation in the US is pretty respectable, having come down from over 9% a few months earlier and against the background of a booming economy. Yes it is double that- at least until the October data is released- in the UK, but still clearly on the way down . And look at the ECB- the October flash estimate showed a fall in inflation from 4.3% in the eurozone to just 2.9%, the lowest in two years and not much off the ECB target. Yes, base effects matter as a year ago energy costs were rocketing. Not so now. But it is still extraordinary to see how , though inflation has been rather volatile in individual countries in the last few months, we have inflation in Germany down to 3.8%, 4% in France, 1.8% in Italy, 0.4% i Belgium and actual deflation in the Netherlands! And in all those cases it is mostly energy costs and food prices falling that made a difference, rather than the interest rate increases even though they are crippling the economy.

What are we therefore waiting for? The EU is in contraction territory. GDP fell by 0.1% in the last quarter. In the UK the BoE is now forecasting stagnation for most of the next 4 quarters. The impact on household finances is obvious in falling retail sales and homebuilding while businesses that had been encouraged to borrow during the Covid years now find their debts unmanageable. The number of companies in difficulty has increased substantially.

Even my monetarist friends who bemoaned the size of QE during and after Covid are worried. They will tell anyone who listens that the interest rate rises may have been overdone as broad money is falling fast , threatening deflation .

Time to change the tune? Already commentators are predicting that political pressure for central banks to start relaxing again , both here and in the continent , let alone in the US, is bound to increase in the months ahead, especially as some important elections are looming on both sides of the Atlantic.

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