

[Inflation up again](#) [1]

Written by [Tom Clougherty](#) [2] | Tuesday 15 February 2011



So, inflation is up again this month, hitting 4 percent on the CPI measure and rising above 5 percent on the RPI measure. I expect the Bank of England will stick to their story that this is the result of the VAT rise, global commodity prices, and the weak pound. And in an immediate sense, they may be right.

After all, if you want to know about real inflation, you should be looking at the money supply rather than at price indices. And here, although broad money (M4) growth picked up in the final quarter of 2010, it remains relatively weak.

But the Bank is burying its head in the sand if it thinks that inflation is going to go away once external factors fade. Quantitative Easing has led to a quadrupling of the monetary base, and as Andrew Lilico has [pointed](#) [3] out:

Under normal circumstances, one would expect the result of such a huge expansion in the monetary base to be a similar expansion in the broader money supply, and consequently a large rise in the price level (if it were all to occur in one year ? which it wouldn't ? we'd be talking 300% inflation).

That this hasn't happened is down to the economic slowdown ? but once the economy picks up and lending expands, broad money will surge and we could have an inflationary monster on our hands.

Then, as Lilico suggested in the same article, policymakers will be stuck between a rock and hard place. They can either hike interest rates to choke off inflation (and risk triggering mass mortgage defaults and bankruptcies, which could easily spark a fresh crisis in the financial sector) or, more likely, do nothing much and watch inflation spiral towards 20 percent. It's not a pretty picture.

Of course, central bankers have assured us all along that they will be able to undo QE, and pull all that excess base money out of the economy at precisely the right moment. Well, we'll see about that ? but history doesn't exactly fill me with confidence.

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