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QUANTITATIVE EASING INQUIRY

QE, Asset Prices and the Appropriate Macroeconomic Inflation Measure

My evidence only relates to a subset of the questions asked, as I do not have any special expertise in the other areas. I am a Canadian and will not be personally affected by decisions taken by the UK government, or very slightly. However, the UK is in a good position to make reforms that would be emulated by other developed countries around the world, including Canada.

2. Should the Bank of England's mandate be altered?

The mandate should not be altered to include a full employment goal, as this has poorly served the US Fed, and contributed to the financial crisis in the United States in 2008.

However, I agree that the target rate of inflation should be altered to make it more consistent with the goal of price stability. Tim Congdon's goal of a 1% target rate is desirable, although one can't get there all at once. In 2017, I recommended that the Bank of Canada lower the target inflation rate to 1.5% in 2021, with a further drop to 1% in 2026 if that worked out well. Something similar should be contemplated for the Bank of England. I am not sure that even 1% is the lowest target rate possible. This is still with virtual certainty higher than the positive bias in the measurement of inflation, so the "true" inflation target rate would be comfortably above zero.

One advantage of a 1% rate in terms of the Bank of England's current framework, is that with the customary one percentage point range between the lower bound and the target rate, the lower bound would be 0% inflation. Any lower target rate would either entail a negative lower bound or a reduction in the range between the lower bound and the target rate. The one-percent range is reasonable, and there is a risk that a negative lower bound would make market participants skittish. However, it would probably be better to reserve a detailed discussion of this issue for when the target rate has been lowered to 1%, and economic performance has been encouraging at that level.

7. What trade-offs does the Bank of England's Quantitative Easing programme entail? What effect might it have on inflation?

It is generally agreed that QE tends to inflate asset prices, including housing prices. Unfortunately, the Bank of England's target inflation indicator, the UK CPI, while a macroeconomic measure of consumer prices, excludes housing prices, and so is not as sensitive to the inflationary impact of QE as it should be. The CPIH, promoted by the ONS as the one index to rule them all, has the same defect. It does not include housing prices explicitly, although conceptually, imputed rents do reflect depreciation costs and so should be somewhat sensitive to changes in dwelling prices. However, it would be better if the CPI were replaced as the target inflation indicator with a CPIH(NA) series, where the owner-occupied housing component was calculated using a net acquisitions approach. The gross weight, gross price variant (i.e. where both expenditure weights and price indices relate to the house (dwelling and lot) rather than to dwellings, is to be preferred to the net weight, gross price variant now calculated by the ONS in its experimental monthly OOH series.

One should also consider adding net acquisitions of art works by the household sector to the macroeconomic inflation measure. These would rightly be excluded from a household-oriented measure of inflation because of their investment aspect, but since they, probably even more than houses, will have their values inflated by QE, it would be useful to have them in the target inflation indicator of the Bank of England.

It should be noted that even if it was decided to refrain from QE in future, reform of the target inflation indicator in this way would still be desirable. The substantial use of QE would only make it more necessary and useful.

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