

Marketplace



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‘If Mervyn King should be awarded a medal for his bravery before a solid redoubt of fact, he also deserves a prize for the exceptional selectiveness of his memory’

As exercises in self-exculpation go, Sir Mervyn King’s 2012 BBC *Today* programme lecture deserves a medal. Rarely has so much bravery, indeed foolhardiness, been displayed in such total disregard of the facts.

The Great Recession of 2008 and 2009 was the UK’s worst setback in demand and output since the 1930s. Official statistics on the matter are clear-cut. In the year to the first quarter (Q1) of 2009 spending slumped by 8.4 per cent, far worse than in the previous record postwar decline, which was 5.3 per cent in the year to Q4 1980.

Further, whereas policymakers in 1980 had the excuse that the pain of recession was justified by the subsequent gain of the annual inflation rate being cut from more than 20 per cent, the pain of the Great Recession has had no anti-inflation gain whatsoever. In fact, inflation has been a little higher in the last few years than before the Great Recession.

The narrative of the latest boom-bust episode has been similar to that in other cyclical upheavals over the last 40 years. Banking system delinquencies have been the source of the rise and fall of expenditure from 2006 to 2010, just as they were in the rise and fall of expenditure in the Heath-Barber boom-bust of 1971 to 1974, and in the rise and fall of expenditure in the Lawson boom and exchange-rate-mechanism bust of 1986 to 1992. In all three dramas banks expanded their loan portfolios too rapidly, which led to unduly high growth of the quantity of money (that is, of bank deposits).

High monetary growth was accompanied by buoyant asset prices, particularly of the prices of houses and commercial property. That stimulated strong increases in consumer spending and corporate investment, putting strain on the nation’s resources and upward pressure on inflation. Action has been taken to check the banks: in past cycles by sharp rises in interest rates and in the latest one by regulatory bank-bashing. Within a few quarters the rate of money growth has collapsed, asset prices have fallen, both the household and corporate sectors have retrenched—and so on.

Yet, unbelievably, King said in his lecture that “there was no unsustainable boom like that seen in the 1980s; this was a bust without a boom”. Readily available data demolish these claims. The average growth rate of domestic expenditure since 1955, when the numbers were first prepared in their cur-

rent form, has been 2.4 per cent a year. As noted above, in the year to Q1 2009 domestic expenditure dropped by 8.4 per cent. But, just a few quarters earlier, conditions were radically different. In the year to Q4 2007 domestic expenditure climbed by a well-above normal 4 per cent, while house prices were at their highest-ever levels relative to income.

King says that no worrying signs of extra inflation were evident in 2007. But the quantity of money was already ringing alarm bells about rising prices at that stage. In the two-and-a-half years to the end of 2007, the Bank’s preferred measure of money (known technically as M4x) soared at an annual rate of 9.7 per cent. King denies that anyone forecast inflationary retribution from this sort of excess, saying that “no one believed [above-target inflation] could happen”. In fact, a group of nine economists wrote a letter to the *Financial Times* on September 27, 2006 highlighting the dangers of high money growth. (I know that there was such a letter because I was one of the nine, and was indeed responsible for the organisation of the letter and wrote its early versions.)

If King should be awarded a medal for his bravery before a solid redoubt of fact, he also deserves a prize for the exceptional selectiveness of his memory. In the *Today* programme lecture he attributes the troubles in the banking system to Gordon Brown’s 1997 decision, on advice from Ed Balls, to take the power to regulate the banks away from the Bank of England. According to King, he and his officials were reduced to “preaching sermons”—and “we did preach sermons about the risks”. This forgets King’s initial view of the matter. According to Alex Brummer in his 2008 book *The Crunch*, relying on the testimony of insiders, he was “cock-a-hoop” when he heard what Brown and Balls proposed to do.

King’s reputation is now in tatters. As I discussed in my Hobart Paper, *Central Banking in a Free Society* (Institute of Economic Affairs, 2009), he has always disdained the City of London (which he doesn’t understand), and preferred to concentrate on macroeconomic analysis (which he does, sort of).

The next Governor of the Bank of England needs to show empathy with banks and knowledge of their industry, as well as a degree of humility, even cowardice, when discussing the statistical record.