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Beyond Unprecedented
"Inflation: Not Dead Yet"
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[00:00:03] **Huw Pill:** We've had a series of inflation shocks that have just come one after the other. A real goal of the central bank as the monetary policy makers is to try and ensure we have price stability. We try to provide an anchor for expectations in the economy and expectations for financial markets.

[00:00:21] **[Music and media clips of journalists saying "unprecedented"]** The coronavirus pandemic has tanked the global economy with unprecedented speed. The steepness of the decline here is unprecedented. This is a crisis that is unprecedented. It is unprecedented, and we just don't know.

[00:00:36] **Eric Talley:** This is *Beyond Unprecedented: The Post-Pandemic Economy*, a limited-series podcast from Columbia Law School and the Ira M. Millstein Center for Global Markets and Corporate Ownership. I'm Eric Talley, Sulzbacher Professor at Columbia Law School and co-director of the Millstein Center.

[00:00:51] **Talia Gillis:** And I'm Talia Gillis, associate professor of law and Milton Handler fellow at Columbia Law School. Today, we'll dig into a phenomenon we've all been feeling over the past few months: inflation. It's become a huge issue and one that most people under 40 have never really had to experience, particularly in the U.S. and Western Europe. What's happening? What are the factors that drive inflation, and how can regulators and others act to curb the tide of rising prices?

[00:01:21] **Talley:** This inflationary episode that we're in right now is concerning, but I have to tell you, it makes me feel young again because I still remember the high inflation periods of the late 1970s and early 1980s. And you know how kind of crazy it was at the time. I'm guessing you are not in my camp, are you?

[00:01:40] **Gillis:** No. I grew up in Israel, and so Israel had one of these extreme episodes of hyperinflation in the 1980s. Like in 1984, for example, inflation rates were 445%. So really, really high. This was one year before I was born and a few years before I was financially aware. So the direct lasting impact and in how to manage my finances probably didn't have the same impact as you, Eric. But I do think there's kind of been this lasting impact on society that I did experience. So the pegging of consumer contract prices like rent to the U.S. dollar in Israel is something that kind of originated then, but it's something you see even today. This is 40 years later. I also think hyperinflation in Israel caused a lot of financial misconduct. There were all these

incidents of banks artificially inflating their stock. So it was really kind of this turning point in terms of awareness of misconduct for a pretty young country at the time, Israel. There are a few ways in which indirectly hyperinflation really has had a lasting impact in Israel and my life, too.

[00:02:40] **Talley:** All right. Well, even if you didn't get to experience hyperinflations on the price of Aerosmith and Led Zeppelin T-shirts, it's still an issue now. And today we are thrilled to be joined by Huw Pill. Huw is the chief economist and executive director of the Monetary Analysis and Research Group at the Bank of England. Previously, he was chief European economist at Goldman Sachs. Huw has also had multiple stints on the faculty of Harvard Business School. And I know this is the program on inflation and not to inflate his credentials even more, but perhaps Huw's most impressive skill is that he had the temperance to put up with an untidy, irreverent Yankee—myself—in a very, very small graduate student apartment during the 1990s. So welcome, Huw, to the show.

[00:03:26] **Pill:** Thank you, Eric, and thank you, Talia, for inviting me. It's a great pleasure to be here.

[00:03:31] **Talley:** I'm glad to have you here. Let me have you help us set the stage a little bit here. So over the past couple of years, there have been several economic shocks that have moved inflation substantially higher than what we got used to in the early 2000s—the 0 to 3% rates of inflation. And before we get to sort of what these recent episodes have been, let's maybe set some benchmarks about what inflation should be, at least according to contemporary central bankers and monetary economists such as yourself. Central banks in many countries, including the Bank of England, the U.S. Fed, and so forth, have tended to set an inflation target of around 2% as a goal. But was that always the case? How do we get to this 2% inflation sort of rule of thumb? And why is it thought to be important?

[00:04:20] **Pill:** A real goal of central bankers and monetary policy makers is to try and ensure we have price stability. And of course, to the question, what do we mean by price stability? Well, Alan Greenspan, former chairman of the Federal Reserve, he famously described price stability as a situation where developments in inflation don't affect the decisions that households and firms are making about investment, about spending, about where they choose to send their kids to college, whether they choose to buy a house. And the thinking behind that is if you can ignore those things, you can focus on the decisions that are really important to you, right? How you trade off investing in a factory today by putting your cash in the bank. If everything's being distorted by inflation, then you might make wrong decisions, you might make misinformed decisions about those types of things, and that will interfere with the productivity growth, with the innovation, with the dynamism in the economy. Now, of course, then it comes down to the question, if you want price stability, why focus on one specific number, 2%? Well, there's a number of reasons for that. First of all, we're just trying to be transparent. We're trying to explain what we're doing in a measurable way. And what that helps us be is also accountable. So it's very important for us to be clear about what we're trying to achieve. And then if we don't achieve it, people could complain and hold us to account and, you know, in the end they can get us to change course if necessary. We're trying to provide an anchor for expectations in the economy and expectations in financial markets. So, you know, most financial instruments will be

priced at least partly depending on what the outlook for inflation is. And if we can anchor inflation credibly at 2%, then that gives them something to anchor on and manage developments and price assets in financial sector more effectively. There's nothing really magic about 2%. Would it make a massive difference if it was two and a half percent or 3% or one and a half percent? I think probably the answer to that is no. We want to put grease into the wheels of the market by having a little bit of inflation that allows all prices to change.

[00:06:30] **Talley:** For much of the 2000s, until literally last year, we were, you know, in this multidecade moment, really, of historically low inflation. By the summer of 2022, the worm had turned pretty dramatically, right? Inflation in the U.S. was as high as 9.1%, depending on how you measure it. There are a lot of factors that were associated with it. You know, some maybe short term factors such as supply chain crunches having to do with the COVID-19 pandemic, maybe other things having to do with Russia's invasion of Ukraine. But there are other forces at play, too, right? More permanent forces that cause, you know, prices to rise faster than costs are increasing. So where do we sit now, from your perspective, on how much of these inflationary pressures are transitory versus much more durable in their nature?

[00:07:25] **Pill:** We are very focused, I think, in the central banking community and the monetary policy community, on the persistent component of inflation. The reason for that as a starting point is that that chain, that transmission mechanism of what we do by setting rates, how long it takes that to feed through into having an influence on inflation, working through the banking sector, then having Talia go to the bank, get her mortgage, buy her house, and change her spending decision—that chain of transmission, it comes with quite long lags. So when we move bank rate or the Fed moves the Fed funds rate, that probably has its biggest effect on inflation in the U.K. or U.S., respectively, in about 18 months time. If some disturbance hits the economy today, and it feeds through to inflation tomorrow, if we change interest rates today as soon as we saw that disturbance, we'd be having influence on inflation in 18 months time—much too late to offset the sort of impact effect. So that's two implications: One is there will be some volatility in inflation around this 2% target, which is just unavoidable, and we kind of have to suck it up. But also when we're trying to set policy out rates, we have to make forecasts basically to ensure that we begin to have that impact on inflation at that 12 to 18 month horizon. That is, we have the right impact at that point. So a key question for us then is, what's causing that persistence? Because inflation has been higher than we expected. It's been higher than we expected for longer, and it's an undesirably long time. So inflation started to go up about 18 months ago. We don't have that excuse now so easily that, you know, we just couldn't get, even if we'd acted immediately, we couldn't get it to effect because of these lags. The technology available for monetary policymakers was too slow moving. One story is, there's been a set of shocks. If you read Lemony Snicket, it's the series of unfortunate events that have just all gone in the same direction, right? And so how unlucky can you be? The pandemic simultaneously both disturbed supply and the economy. We know all those stories about ships being stuck in Shanghai not being able to bring things to Long Beach. And so therefore, there were fewer iPhones just at the time when the government was giving those stimulus checks to American households. So American households were flush with cash. They all wanted to buy the new Xbox in order to play at home because they couldn't go to work or go to the restaurant or go to the bar. That led to more demand on our supply,

prices go up, that's inflation. But just as that story was beginning to turn over, pandemic was receding. We then saw the Russian invasion of Ukraine. The Russian government turned off the tap on natural gas supplies from Siberia and from Russia into Western Europe. And the consequence of that is, well, wholesale European gas prices from when I started working at the bank in 2021 to that peak in August last year, they rose about 12 times. I mean, that's more than 1,000%. And even though gas or energy or fuel and utility bills is a relatively small proportion of spending in the U.K., say it's about 5 or 6%. You know, you just do the arithmetic. Something goes up 1,000%, and you multiply it by way to 5%, you're still getting a massive contribution to inflation of five or six percentage points, and that's moving us from our 2% target close to double digits. And that's exactly what happened. But then over the last few months, gas prices have come off, right? So, you know, that's working in our favor. But what's happened there? You know, we've seen rises in food prices. Now, part of that was avian flu. Part of that was we saw crop failures in southern Europe and North Africa. So all the avocados became super expensive. We didn't have any eggs, all that type of stuff. We've had a series of inflation shocks that have just come one after the other. Each of those shocks was in itself transitory, but they just were timed in a way that inflation never dissipated. Now that's a pretty convenient story for a central banker to tell, and that is a story we tell. But maybe it's not the whole truth, right? And so, you know, there are two parts to that. One part might be, could we have anticipated some of these shocks? And I think there is good economic research, for example, looking at supply chains that if we had understood supply chains better than we did, we could have probably understood that this was going to be a more difficult process than we anticipated. The crucial thing is is that the behavior of price setters, wage setters in the U.K. economy, in the U.S. economy, will change. When your energy bill you get every month at your house goes up four or five times, that's eating into your income. What's the natural thing to do? Well, the natural thing to do is say, I need to be paid more. If you're a household . . . . What's the natural thing to do if you're a restaurant? The natural thing to do is say, I need to raise the prices of my meals in order to compensate for the fact my gas bill is now higher. But then, of course, that process is ultimately self-defeating. In the end, the U.K., which is a big net importer of natural gas, is facing a situation that the price of what you're buying from the rest of the world has gone up a lot relative to the price of what you're selling to the rest of world, which is mainly services in the case of the U.K. And so that means you don't need to be much of an economist to realize if what you're buying has gone up a lot relative to what you're selling, you're going to be worse off. So somehow in the U.K., someone needs to accept that they're worse off and stop trying to maintain their real spending power by bidding up prices, whether higher wages or passing the energy costs through onto customers, or etc. And what we're facing now is that that reluctance to accept that, yes, we're all worse off, and we all have to take our share to try and pass that cost on to one of our compatriots, and saying we'll be alright, but they will have to take our share too. That pass the parcel game that's going on here, that game is one that is generating inflation, and that part of inflation can persist. How much bargaining power, how much pricing power exists for different actors in the value chain on the corporate side or in the labor market? And at the moment, the relatively low level of unemployment, the strength of corporate pricing power, and so forth in the U.K. and the U.S., I think, they're all running a little bit too strong. And so that's why interest rates have gone up. That's trying to cool demand in the economy down, and that's ultimately trying to ensure that that process, if you like to pass the parcel, is consistent with the 2% you mentioned earlier.

[00:13:52] **Gillis:** Since March 2022, the Fed has raised rates from near zero to target range between 4.75 and 5%. Similarly, the Bank of England has increased the key rate from 0.1% to 4.25% since December 2021. What are the limits and the potential hazards of using this tool aggressively? What do you look at to know when interest rates have hit the right level, particularly in light of what you said about the delayed impact of increasing rates?

[00:14:20] **Pill:** I think you're right to point out that a lot of what I've said is, in the face of high inflation, we need to tighten policy, and that's the process we've been in. So we need to make sure policy is tight enough to weigh enough on demand that that whole process of bargaining, that level of demand economy, results in inflation, that's a target. But of course, if you need to do enough, the danger always exists that you do too much. And if you do too much, what happens when you weaken demand excessively? You might cause a recession. Most things in life are about, it's trying to find that balance. Not too much, not too little, but just right. This is the kind of Goldilocks story. We need to be looking forward exactly to calibrate our policy decisions to have the right impact when those lags in transmission unwind. But as I think Yogi Berra—who's probably someone Eric knows better than me but I believe is sort of a baseball-philosopher combination—but I think he famously said something like, you know, it's hard to make forecasts, especially about the future. And I think that really gets down to a lot of what practically on a day to day basis we are trying to do. That is basically the process we go through here at the Bank of England every six weeks, where we have these monetary policy committee meetings. And in making those forecasts, we're looking at all the available information we have. So there's lots of economic data. So, you know, we look at GDP, we look at measures of inflation itself, we look at wage developments, we look at different components of all those things. We look at consumption, investment, exports, imports, exchange rate, asset prices. Increasingly, we also try and look at more exotic data and use more exotic techniques like AI techniques and so forth because there is a lot of information out there that probably isn't being captured as effectively as we might like. It's very much on our agenda to move in that direction. Would it be transformative to monetary policy? I'm not sure. I think monetary policy is a pretty old fashioned kind of game. It's a pretty slow moving kind of game. We shouldn't be at the bleeding, cutting edge of technology just for the sake of it. We are famously a conservative bunch in the central banking world, but I think we do need to move in the direction of using new data techniques and new data sources. And this is definitely what we're seeking to do.

[00:16:33] **Talley:** Talking about Yogi Berra, one of his famous quips was about inflation. He was said to say a nickel ain't worth a dime anymore. [Laughter] So I want to kind of push you a little bit more on like which direction, how much, how far is too much? How fast is too fast or too slow? We had been lulled into this kind of expectation that inflation was almost permanently 2% or even close to zero, and it moved incredibly quickly and incredibly violently, as did interest rates, because of concern about the inflationary pressures. And that's placed a lot of strain on the banking industry on both sides of the Atlantic. So a poster child in the U.S. is the now defunct Silicon Valley Bank. They threw a bunch of their assets, right, while they're waiting for people to take deposits, into government bonds and agency-backed bonds. Default risk is super low, but if there's a sudden increase in interest rates, the value of these things can fall precipitously. And

that's effectively what happened. And as some of their clients, you know because VC industry was also slowing down, started to pull money out. They had to start taking write downs on their assets, and that essentially caused a big collective freak out. Signature bank about the same time failed. A third, First Republic, had to be bailed out by a group of big U.S.-based, largely U.S.-based banks. It soon spread overseas, and Swiss regulators, you know, hammered out a kind of a shotgun marriage acquisition of Credit Suisse into another big Swiss bank, UBS. I guess the concern is that these examples aren't completely aberrational. I kind of feel for the tension of a central banker here, right, trying to say we've got to take aggressive moves to slow down the economy. But then, you know, a quick change in interest rates can cause some of these financial institutions to kind of end up upside down. And so when you're trying to make your own decisions on the if and how fast questions on rate changes, how do you think about like the general fragility in the financial system, you know, sort of writ large and going forward?

[00:18:34] **Pill:** I think the Fed waited to move rates a bit longer than we did at the Bank of England, but then moved them faster. And there were those who say we should have gone quicker here in the U.K. more similarly to the Fed. We should have moved earlier. So there will always be a debate, I think, about too far, too fast, too slow, too little. Central banks are responsible for monetary policy, and that's kind of my main job here at the Bank of England. But we're also responsible for supervising banks in many respects and also for responsible financial stability. And all these things are naturally complementary to each other. When we move interest rates, I mean, the key thing then is, the financial system has to work. If the financial systems is in panic, if the financial system is in stress, that transmission of policy will be disrupted, and then we will not be able to achieve our monetary policy goals, let alone our financial stability goals. The U.K. has not been immune to the similar events. Last autumn—maybe triggered by changes of government in the U.K. and different fiscal choices in the U.K., fiscal policy, tax and spending policies by the government—we also had our sort of financial aberration, and that led to a lot of pain, and that was actually in the non-bank sector. So lots of different jurisdictions are facing these problems. And I think you're right, they all fundamentally reflect the fact that we've been in a world where the expectation was interest rates were low and would stay low because we had conquered the inflation problem. So what are we doing? Well, I think central bankers on the monetary policy side, we like to be predictable. We like to move gradually. We don't want to shock people, right? So to some extent, the reason why we didn't just move interest rates from 0.1% to about 4% in one leap is that we were trying to manage some of these risks. We were trying to prepare the ground. We were trying to signal to people that this is going to be a process. We have to raise interest rates because inflation is there. We need to tighten policy, but we're going to do it in a gradual, persistent and kind of resolute way. So that's been the sort of language that I have emphasized. It's interesting that people now are more on that side. There was a long time when they were saying you're being too slow, right? Inflation has gone up to double digits in the U.K. You need to be raising rates faster. And I think recent events have moderated that. But one crucial thing is that what we're going through and what you described is really the first test of the new kind of post-global financial crisis regime. And that's a regime which says, we use regulatory measures and sort of so-called macroprudential measures to try and maintain stability in the financial system. And what we are doing on the monetary policy side is relying on the fact that our colleagues in the other side of the bank are doing their job. Looking at

the banks, stress testing the banks, so forcing the banks to go through scenarios: What would happen if interest rates go up? What would happen if bond prices fall? We do have a certain degree of confidence that within the banking system, the core financial system, that there is a robustness, a resilience there. But what we're not doing is somehow saying, oh my God, there's such a problem in the financial sector that we need to be distracted from our objective of price stability, getting inflation back to 2%. And I think that's the real test of the system.

[00:21:50] **Talley:** Silicon Valley Bank famously was pulled out from the stress testing rubric within the U.S. And even if they stayed in, I think the basic stress tests that the Fed was using for 2022 didn't plug in an inflationary scenario. It was other sorts of scenarios. I'm guessing that we're going to have, certainly in the U.S. and maybe in the U.K. as well, more of a fulsome kind of reassessment of all the different scenarios that are kind of necessary for stress testing.

[00:22:21] **Pill:** So I think that's right. In the U.K., we have really submitted pretty much all banks to what in the jargon is a test of interest rate risk in the banking book. So that has been something that, you know, not just the banks that were international banks that are subject to international sets of regulation which requires that, but all banks have to do that. But, you know, to your point, I mean, certainly there's a whole set of issues here in the U.K. It's as much focused on the non-bank financial sector, the hedge fund world, the pension fund world, the money market world, etc. I mean, to try and think about what are the plausible scenarios? So a stress test that looked very extreme, a sort of 10 sigma, 20 sigma event of rates going up 400 basis points in a year. I mean, suddenly that's reality. So what does stress mean in a world where you've seen that happen? We hope that we've broken the back of the inflation process. We're always going to be hit by some shocks. And so a nimbleness and sort of resilience to those types of shocks is really the core thing. And that applies on the monetary policy side and applies on the financial stability side.

[00:23:29] **Gillis:** Let's talk about one aspect of the relationship between high inflation and consumer behavior: buy now, pay later products. These are short term loans that allow consumers to pay for purchases in installments with no interest, low if any fees, and fast credit approvals. And during the pandemic, buy now, pay later grew in popularity—especially among Gen Z, as we would say—borrowers. And as costs of living have increased, many consumers have turned to buy now, pay later to manage their everyday expenses, from groceries to gas. But with rising inflation, we've also seen increased delinquency in buy now, pay later loans. So according to the Fed, 18% of consumers between ages of 18 and 29 fell behind on their buy, now pay later payments into 2021. And so you started our discussion by talking about how the goal of price stability is that inflation itself does not affect consumer decisions. But perhaps the problem here to some extent is that inflation is not impacting consumer spending enough, and credit is being used to kind of bridge the gap. So what's your take on the dynamic between inflationary pressure and the rise in buy now, pay later and the reliance of consumers on credit more generally?

[00:24:41] **Pill:** Fundamentally, what's going to drive prices up? In aggregate, in individual parts of the economy, it's when demand grows strongly relative to the availability of the goods people want to buy. So I certainly agree with you that the

availability of easy credit and these buy now, pay later type schemes is one aspect of that. But, you know, there are lots of other aspects of easy credit that are out there. The availability of easy credit may be on terms that are not being as closely influenced by regulators and or by the monetary policy decisions of the central bank. Some of these buy now, pay later are using innovative credit scoring schemes and that type of thing. We definitely want to embrace innovation because innovation is one of the things that will drive better allocation of resources, that productivity, dynamism, and better living standards. But we want that innovation to take place within an environment that doesn't generate excessive risk. In the lead up to the global financial crisis, we saw quite a lot of financial innovation. Some of it was very positive, but some of it was misdirected, and it led to an overextension of credit, which then transmitted to the system and really had a big cost on the global economy and the U.S. economy. And what I think we need to make sure is, is that when we have these innovations on the financial sector side, that we ensure that that safety is there, that that good regulation is there, that allows the type of innovation to take place in a productive way. I think that probably is the right way to set ourselves up at the present.

[00:26:12] **Talley:** Okay, Huw, I want to ask you one last aphorism from our baseball prophet-poet Yogi Berra, who once said you can observe a lot just by watching. So in the coming months, what are you going to be watching to more assess what the inflationary outlook is going to be like in the next 12 to 18 months? And what sort of measures will you be looking at to try to figure out when the Bank of England has done enough to cool down the inflationary pressures sufficiently?

[00:26:39] **Pill:** So for me, the absolute key thing is to keep this focus on the persistent sort of underlying component of inflation. So in the U.K. context—and this is true to some extent in the U.S. too—we've seen natural gas prices rise 11, 12 times. We've seen them then fall back not far off where they started. That's going to create a lot of movement in headline inflation. We may actually see headline inflation go below our 2% target over the next couple of years. But the key thing is that there's not much we can do about that precisely because this has all been driven by things that have already happened. We're very focused on this process of, what's that part of inflation that's going to persist beyond that 18 month, two year horizon? It is about how much we see wage growth in the U.K. economy push to try and reclaim what's being lost in terms of real spending power on the part of households. And I think by the same token, how much there's pressure on the corporate side to try and push up profit margins. That might seem like a simple thing to measure, but it turns out there are lots of different measures and lots of different idiosyncrasies about how we do that. On the labor market side, that's about the level of unemployment. How tight is the labor market? On the corporate side, it's about the level of demand. It's about the stresses and value chains, and so forth. One indicator that in the U.K. we think is quite telling is services price inflation, because that's something which has kind of been driven more by developments in the U.K. We're focused on what's going on domestically, and domestic core inflation is really key there. But what's key in all of that is that we can't just look at one or two individual indicators and say this tells us everything. We want to convince people, yes, we're going to get back to 2%. We're going to look at everything. I've highlighted a couple of things we think are important, but they're important insofar as they . . . our story about whether inflation is going to be more persistent or not. So it's always going to be, know what you're trying to do, know what data is most important for

that in the current circumstances, but be flexible as the story changes, we may need to look at broader or a different set of things.

[00:28:55] **Gillis:** Our guest today was Huw Pill, chief economist and executive director for monetary analysis and research at the Bank of England. Thanks so much for listening. Make sure to follow us on Apple, Spotify, or wherever you get your podcasts.

[00:29:19] **Talley:** *Beyond Unprecedented* is brought to you by Columbia Law School and the Ira M. Millstein Center for Global Markets and Corporate Ownership. This podcast is produced by the Office of Communications, Marketing, and Public Affairs at Columbia Law School. Our executive producer is Michael Patullo. Julie Godsoe, Cary Midland, and Martha Moore, producers. Editing and engineering by Jake Rosati. Special thanks to Erica Mitnick Klein and Molly Calkins at the Millstein Center with research assistance from Alice Legrand. If you like what you hear, please leave us a review on your podcast platform. If you're interested in learning more about law, the economy, and society, visit us at law.columbia.edu, or follow us on Facebook, Twitter, and Instagram.