{ MONETARY POLICY }

JEREMY WARNER

Quantitative easing has not boosted the economy, so should the chancellor eat humble pie?

When he came to power, prime minister David Cameron said the UK government would be guided in its approach to the economy by a combination of "monetary activism and fiscal conservatism".

With public indebtedness apparently out of control, it seemed a sensible enough strategy. A sustained fiscal squeeze would be applied to bring the deficit under control, but there was an unspoken agreement that the Bank of England would try to counter the adverse consequences for growth with exceptionally loose monetary policy.

More than two and a half years in, and it's plain for all to see that this mix of loose and tight hasn't really worked. Loose money has failed to bring significantly easier credit to business and households, but by allowing higher inflation, it has certainly had a quite chilling effect on real incomes, further undermining demand and growth. Lack of growth has, meanwhile, forced the government to slow the pace of fiscal consolidation, so that the chancellor cannot even boast that he is bringing the deficit under control. Current spending has been only marginally reduced in real terms since the coalition came to power.

Chancellor George Osborne is left with the worst of both worlds – he's not been able to impose the austerity necessary to get the public finances back under control, nor has he managed to deliver any growth. Britain's economy has become frozen in time. The government is just treading water.

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This is not a situation unique to Britain; to a greater or lesser extent, most advanced economies are in much the same boat. But shared misery is not going to make the voters any more forgiving, and Osborne knows it. He needs to come up with something fast if he's to survive the next election.

One possible ray of hope is the arrival in June of Mark Carney as the new governor of the Bank of England. This appointment was, in a sense, Osborne's finest hour. The reaction was ecstatic: even the chancellor's deadliest enemy, shadow chancellor Ed Balls, was moved to congratulate him on a fine choice.

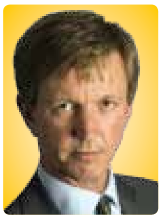
Can Carney make a difference? Well, possibly he can, though admittedly, it is hard to see how he could make monetary policy any easier than it already is. It is also most unwise to put too much faith in the power of central bankers. They can slow and smooth an economic adjustment, but they cannot eradicate it.

There are things he could do, however. For instance, he could apply future programmes of 'quantitative easing' to asset classes other than government bonds, and by committing to keep the monetary dial on full until certain economic objectives are met, he could provide business with a greater degree of confidence about future monetary conditions than it has at the moment.

He could also ease back a little on the bank solvency crusade, which under Sir Mervyn King, the present governor, has become so oppressive that it is turbocharging the deleveraging process in a highly counterproductive fashion. Of course, banks need more capital. But the time for them to be addressing capital issues is in good times, not the bad.

The same counter-cyclical principles apply to the fiscal side of policy. Osborne has been unlucky in his strategy, which might have succeeded but for the collapse in external demand triggered by the eurozone crisis and the surge in global commodity prices.

But just to sit on your hands and wait for things to correct themselves is no kind of strategy. Osborne needs to do something bold in the March Budget to kick-start the economy, even if it involves the humiliation of having to admit that, up to a point, Balls may have been right all along. Any such strategy must start with tax cutting. Better to eat humble pie than lose the election.



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