British PM's downward learning curve

May and Carney: recipe for sterling weakness

by David Marsh

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Theresa May, the British prime minister, has been on a steep learning curve since being catapulted into office in July just three weeks after the British No vote to European Union membership. Over the last month the curve seems to be heading downwards. If she wants to get back to positive territory, she will need better advisers. A clear indication has come from the weakness of the pound.

There is one lesson from successive sterling crises over the past 100 years that governments ignore at their peril. At a time of foreign exchange market nervousness, creating an impression of divisions with the governor of the Bank of England is a guaranteed source of downward currency pressure.

Over the last few weeks, May has ignored that rule. Perhaps, given the paucity of economic advice she seems to be getting from her Home Office-influenced inner circle at 10 Downing Street, she is unaware it exists.

The damage may well be all the greater on this occasion, since the Bank of England has, since 1997, maintained operational independence in setting interest rates.

When May took over from David Cameron on 13 July, the pound's trade-weighted index had already fallen 9.3% since the 23 June referendum. This might have been regarded as a helpful legacy. She might arguably have been forecast to benefit from a devaluation-induced pick-up in economic activity.

A two-month interregnum followed in which the trade-weighted index hovered in stable fashion around 80 (January 2005=100). However, since mid-September, the index has dropped a further 6.5%, with most of the decline coming since the Birmingham conference of her Conservative party at the beginning of October. A necessary correction has turned into a potential crisis.

In a conference speech designed to appeal to the party faithful on 5 October, May criticised the Bank of England's low interest rates and quantitative easing, which she said had led to 'bad side-effects' through low returns for hard-pressed savers.

In a passage that seemed to assume that no one outside the conference centre might be paying attention, May added, somewhat ominously, 'A change has got to come. And we are going to deliver it.' One senior policy expert, reflecting in far-away Washington on what appeared to be the message, told me, 'The government seems to have ended the Bank of England's independence.'

May is following a line of attacks on respective central banks over low interest rates: in the US, by Donald Trump, the Republican presidential candidate; in Germany, by Wolfgang Schäuble, the finance minister. This must be the first time in modern history that central banks are under assault not because money is tight (the politicians' traditional complaint), but because it is too loose.

The British prime minister's interest rate offensive is notable because it is the only one voiced when the currency in question is already under pressure. Furthermore, it has been followed up by anti-Bank of England declarations in the press by William Hague, the former UK foreign secretary and Conservative leader widely regarded as a May sympathiser.

Mark Carney, the governor – already under fire from Brexit enthusiasts who accuse him of siding with the Remain camp before the referendum – has been forced to state that he does not 'take instruction' from politicians. Philip Hammond, the chancellor of the exchequer, has had to issue a ritual defence of Carney's independence and say he should stay on until the full legal expiry of his term in 2021. All of this only seems to confirm that Carney is under pressure.

Carney has not made his life easier by saying, when he first took the job in 2013, that he wished to serve only until 2018. Some of his adversaries wish to hold him to this. Were Carney to walk away, it would amount to the biggest disagreement at the helm of the Bank since Lord Cromer, the incumbent in 1966, stepped down after a row with Harold Wilson, the prime minister. If that were to happen – just as was the case 50 years ago – sterling would surely be the loser.

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