Shadow Monetary Policy Committee

Tuesday 20th July 2004

In attendance	David B Smith (Chairman) Professor Philip Booth (IEA) Dr Andrew Lilico John Greenwood Professor Anne Sibert Dr Peter Warburton
Present by invitation	Allister Heath Yoko Fukumoto
Apologies:	Professor Peter Spencer Professor Forrest Capie Professor Kent Matthews Professor Tim Congdon Professor Patrick Minford Gordon Pepper Roger Bootle

Minutes

Chairman's opening remarks

It was agreed that we would conduct a monthly telephone or email poll, starting this autumn so that a monetary policy view could be expressed monthly.

Monetary situation (presented by Dr Peter Warburton)

The world economy seems buoyant with global GDP growth of 4% expected for 2004. Global inflation remains subdued at around 2.5% with no clear trend emerging. World export growth has picked up with China being a strong component. US employment growth has recovered more impressively in terms of headcount than in total hours worked. The US began the expansionary phase of the cycle with an unusually large current account deficit of 3% of GDP; this trade deficit has now widened to 6% of GDP.

US money growth does not appear to be at levels that would suggest a significant rise in inflation is imminent. Growth in both narrow and broad money is at the level 5% - 6%.

Euro zone, money supply growth has decelerated over the past three months.

Real GDP growth in Japan is officially over 4% in Japan, but it is thought to be overstated as a result of exaggerated deflation. GDP growth has picked up mainly on the strength of exports and export-related capital expenditures, but domestic demand conditions remain weak.

Growth in the UK still appears reasonably strong and there has been a revival of business investment. Government sector GDP growth is strong but private sector growth is weak. This reflects a transfer of resources from the private to the public sector through increased government spending that is reflected in higher taxation and borrowing.

Private sector goods and services inflation is low (around 1% per annum). Commodities and administered sector prices are rising briskly. Private sector saving is still low. Government receipts seem to be weakening which has implications for future government borrowing. Wholesale monetary growth is subdued. Bank lending to individuals, particularly secured lending, is still growing strongly.

General Discussion

The relatively weak domestic situation in Japan was discussed as was the integrity of the recovery in the US.

In the UK, recent data revisions from the ONS suggest a higher level of GDP than previously thought. This implies a significantly tighter output gap than was earlier believed. It was noted that Gordon Brown's assumptions outlined in the recent spending review are very optimistic. Concern was expressed about the consequences of the massive transfer of resources out of the private into the public sector for the future growth of real GDP. This could necessitate a corresponding reduction in monetary growth and increase in interest rates in order to achieve the same inflation outcome. However, it is also the case that the private sector is probably weaker than is implied by the official data and that unemployment has been hidden by a transfer into disability benefits.

Interest Rate Discussion

John Greenwood commented that weakness of the private sector might have been overstated. Investment intentions etc. were still strong and there was no clear impact on economic activity from recent interest rate rises. John Greenwood believed that interest rates should be increased by 0.25% given this environment.

Andrew Lilico believed that interest rates at their current level will not dampen down economic activity. He believed that there would be considerable housing market weakness and the Bank of England should therefore raise rates now so that they can be cut more dramatically if there is a housing crash. Andrew Lilico believed there should be a 0.5% increase in base rates.

Peter Warburton did not believe that interest rates should increase. The currency is already strong and there is no obvious threat of future inflation.

Anne Sibert believed that there should be a 0.25% increase she did not believe that there would be a sharp correction in the housing market.

David Smith believed that interest rates should increase by 0.25%. Proposed changes to council tax could cause serious weakness in much of the property market because of the cash-flow problems they would cause for homeowners. He believed that the MPC has run an over-lax monetary policy but this has been in the context of very low real world interest rates and he is not convinced that they had much alternative.

The SMPC voted for a 0.25% increase in interest rates with one vote against.