Shadow Monetary Policy Committee

17th March 2019

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Shadow Monetary Policy Committee votes Six / Three to Hold Bank Rate in March.

In its March 2019 e-mail poll, the Shadow Monetary Policy Committee (SMPC) elected, by a vote of six to three, to hold rates in March. The three favoured a 0.25% rise.

As in previous recent meetings, advocates of holding rates noted that broad money growth continues relatively weak, with some saying that the Bank should consider re-starting quantitative easing if broad money growth does not accelerate soon. Others suggested that with uncertainty about Brexit remaining high, now was an infelicitous time for a rise.

Advocates of raising rates urged that concerns about the impact of Brexit should not deter policymakers from continuing the process of monetary policy normalisation now, given that rates remain far below their equilibrium levels.

The SMPC is a group of economists who have gathered quarterly at the IEA since July 1997, with a briefer e-mail poll being released in the intermediate months when the minutes of the quarterly gathering are not available. That it was the first such group in Britain, and that it gathers regularly to debate the issues involved, distinguishes the SMPC from the similar exercises carried out elsewhere. To ensure that nine votes are cast each month, it carries a pool of 'spare' members. This can lead to changes in the aggregate vote, depending on who contributed to a particular poll. As a result, the nine independent and named analyses should be regarded as more significant than the exact overall vote.

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Votes

Vote and comment by John Greenwood

(Invesco Asset Management)

Vote: No change in rates, but the Bank should stand willing to conduct open market purchases to expand money growth.
Bias: None.

Vote and comment by Juan Castaneda

(University of Buckingham and International Monetary Research)
Vote: No change.
Bias: To hold, and to consider re-launching QE if broad money growth remains so low.

Vote by Julian Jessop

(Independent Economist)
Vote: Hold Bank Rate; Hold QE
Bias: To raise

Vote by Graeme Leach

(Macronomics)
Vote: Hold Bank Rate; Hold QE
Bias: Neutral

Vote by Andrew Lilico

(Europe Economics)
Vote: Raise ¼%, reverse QE (QT) until CPIH-adjusted gilt yields are positive
Bias: to Raise by ¼% each meeting until rates reach 2%

With the House of Commons' decision of 14 March 2019 to postpone or (more probably) cancel indefinitely the UK's departure from the EU on 29 March 2019, the argument for a temporary delay to rate rises at the departure point has lapsed. We therefore reverse to the status quo ante. UK interest rates are far below their natural rate, and that is damaging economic growth over the medium to long term. GDP growth is slow both in the UK and Eurozone and there would be an argument for temporary delay to consider whether that turns into a more sustained downturn or recession. However, in recent years there has always been some event or other, some excuse for not raising rates, and the consequence has been that rates have remained low for a very long time with damaging consequences. Policymakers need to grasp the nettle and restore rates to a level that facilitates faster medium-term economic growth instead of seizing every opportunity to keep rates excessively low.

Vote by Kent Matthews

(Cardiff Business School, Cardiff University)
Vote: No change.
Bias: To tighten.

Vote and comment by Patrick Minford

(Cardiff Business School, Cardiff University)
Vote: Increase Bank rate by ¼%
Bias: Raise further, reverse QE (QT) by £10 per quarter.

Great attention is lavished on the early estimates of GDP when they come out. Yet they are notoriously inaccurate. When ten years later all the data are in, they can be revised by several percent. By contrast, employment and unemployment data are little revised, as they are based entirely on largescale surveys of the labour market. As for the public finances, they are public accounting statistics that are accurate in arrival.

Of course the labour market figures have been telling us clearly that we are at full employment, with wages now rising faster than prices, record employment and unemployment at its lowest since the 1970s- probably lower, since we only had the benefit claimant count then and this routinely lies below the modern survey measure.

But it is the public finances that tell the most upbeat story about the economy. On the basis of the figures up to January the 2018/19 outturn for public borrowing looks like being only £22 billion; down from £72 billion in 2015/16, a fall of about 2.5% of GDP in only three years. Over the same period government receipts have risen about 17%. Usually they rise about 1.4 times money GDP, which would suggest indirectly that money GDP has grown by about 12% in the last three years, about 4% a year. Against this the ONS estimate of money GDP growth is 3.7%. But from this they derive an output estimate of only 1.7% a year growth; yet labour costs have been rising weakly suggesting production costs of GDP may only have been rising at 1.5% a year. The ONS says 2%.

When you set all this also beside the booming labour market, it does indeed confirm that the ONS could be getting growth too low; growth could be more like 2.5% than the ONS' 1.7%. But because GDP revision is glacial we will not know for another ten years, by which time the mistake will be too late to correct the policies that inaccurate pessimism may have caused.

Though until Brexit policy has been decided uncertainty will continue to fog up the economy, monetary policy remains on emergency loose settings which continue to distort the market in savings and investment. By making survival for large incumbent companies facing rock bottom lending rates so easy , yet lending at premium rates to small innovative firms, the economy' growth is being held back.

Vote and comment by Peter Warburton

Economic Perspectives Ltd)
Vote: Raise Bank Rate by ¼%
Bias: To raise Bank Rate in steps of ¼% to 1½% and announce the phased reversal of QE

The experience of the US Federal Reserve, which has implemented 9 quarter-point increases in its Fed funds rate, should embolden the Bank of England's MPC to normalise Bank Rate. US rates have now entered a zone where borrowers are becoming more constrained, as evidenced by softness in the US housing market. However, the US experience is strongly indicative that the initial stages of this rate move were associated with negligible economic costs.

In contrast to the ill-considered August 2016 Bank of England playbook, the bias in the period beyond the threat of a No-deal Brexit, whenever that occurs, should be to higher interest rates across the yield curve. UK monetary trends remain subdued, but not unduly worrying. M4 (ex-IOFC) lending growth is steady at an annual 3.7 per cent pace. The Bank of England Monetary Policy should be emboldened by the resilience of the real economy to press on with measured rate hikes. The next 3 quarter points should be executed mechanistically to return Bank Rate to 1.5 per cent. An announcement of the phased reversal of the QE programme, initially to withdraw the £60bn added in 2016, should be implemented as soon as possible.

Vote and comment by Trevor Williams

(University of Derby, TW Consultancy)
Vote: Hold Bank Rate
Bias: None

Slower economic growth, on target inflation and Brexit generated uncertainty all mean Bank rate should stay on hold. What direction policy goes in over the year ahead depends on the manner in which the UK leaves the EU.

Policy response

1. On a vote of six to three, the Committee voted to hold Bank Rate.

2. The three members preferring to raise rates favoured an increase of 0.25%. All three favoured the commencement of quantitative tightening.

3. By convention, there is, therefore, a decision to hold rates.

Date of next meeting

16 April 2019

Note to Editors

What is the SMPC?

The Shadow Monetary Policy Committee (SMPC) is a group of independent economists drawn from academia, the City and elsewhere, which meets physically for two hours once a quarter at the Institute for Economic Affairs (IEA) in Westminster, to discuss the state of the international and British economies, monitor the Bank of England's interest rate decisions, and to make rate recommendations of its own. The inaugural meeting of the SMPC was held in July 1997, and the Committee has met regularly since then.

Current SMPC membership

The Secretary of the SMPC is Kent Matthews of Cardiff Business School, Cardiff University, and its Rotating Chairman is Trevor Williams (University of Derby and TW Consultancy). Other members of the Committee include: Philip Booth (St Mary's University, Twickenham), Roger Bootle (Capital Economics Ltd), Juan Castaneda (University of Buckingham and International Monetary Research), Jamie Dannhauser (Ruffer LLP), Anthony J Evans (ESCP Europe), John Greenwood (Invesco Asset Management), Julian Jessop (Independent Economist), Graeme Leach (Macronomics), Andrew Lilico (Europe Economics), Patrick Minford (Cardiff Business School, Cardiff University), Akos Valentinyi (University of Manchester), Peter Warburton (Economic Perspectives Ltd), Mike Wickens (University of York and Cardiff Business School).