
IEA Shadow Monetary Policy Committee

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Institute of
Economic Affairs

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Shadow Monetary Policy Committee votes five / four to raise Bank Rate in December.

In its last email poll of 2015, the Shadow Monetary Policy Committee (SMPC) voted to raise Bank Rate by 0.25% in December. The vote was taken against the backdrop of further easing from the ECB and the high probability of a rate rise from the US central bank at its 16th December Federal Open Market Committee (FOMC) meeting.

The vote for a rate hike was based on the view that spare capacity had shrunk; that the output gap had closed; that borrowing by households was now rising strongly; that low rates was leading to misallocations of capital and that to delay further risked more damaging effects than raising now. Those voting for unchanged rates remained of the view that well below target inflation, global uncertainties and slowing growth warranted waiting longer.

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. The next two SMPC polls will be released on the Sundays of 10th January and 31st January 2016, respectively.

Vote by Roger Bootle

(Capital Economics)

Vote: Hold Bank Rate.

Bias: To raise Bank Rate, but not yet.

Vote and comment by Jamie Dannhauser

(Ruffer)

Raise Bank Rate by 25bps.

**Bias: Further very gradual hikes in Bank Rate;
no change in QE stock.**

Inflation below target

Headline inflation, currently at -0.1%, is far below the MPC's mandated target of 2%. At least in an accounting sense, much of the 'inflation miss' is easily explained by the collapse in oil prices (and other commodities) and the lagged effects of a stronger currency. That said, underlying CPI inflation is still uncomfortably low – 'core' CPI inflation (excluding administered prices) was 1% in October, for instance. Current and prospective monetary policy must aim to drive inflation back to the target – but do so in a way that does not undermine other macroeconomic objectives, not least financial stability.

Two major developments in UK

Since the last vote, there have been two major developments in UK policymaking that (potentially) affect the desired path of monetary policy. Firstly, the Chancellor set out a renewed set of fiscal plans, including detailed departmental spending commitments as part of the latest Spending Review. Secondly, the Financial Policy Committee (FPC) published its latest Financial Stability Report, alongside which was released an update to the Bank of England's framework of capital requirements for UK banks. On balance, neither amounted to a meaningful shift in the alternative levers of macroeconomic control.

The planned fiscal profile

In terms of the new fiscal plans, there was much commentary about the extra wiggle room changes in the OBR's forecasts had granted the Chancellor – and his subsequent choice to 'spend the windfall', by easing up on fiscal consolidation. But in reality the planned fiscal profile still embodies a meaningful headwind to aggregate demand. In the current fiscal year, the fiscal squeeze is estimated to amount to 1% of GDP, a figure that rises to 1¼% of GDP in 2016/17 and 2017/18. Towards the end of the parliament, the fiscal squeeze looks set to diminish somewhat but policy only turns neutral in 2020/21. Moreover, in terms of the contents of the consolidation programme, the cuts are set to fall on those bits of government activity, especially government procurement, where fiscal multipliers are likely to be highest.

Considering the FPC

Considering the announcements made by the FPC, many have argued that monetary policy may need to lean into the tightening of capital requirements that will soon be imposed on the banks. The FSR gave strong hints that the FPC was minded to increase the countercyclical capital buffer (CCB) at its March 2016 meeting, effectively increasing the amount of equity that banks would have to operate with. It was suggested that the committee would look to force banks to hold an additional 1% of risk-weighted assets in the form of common equity tier 1 (CET1) capital, the highest-quality form of loss-absorbing equity on a bank's balance sheet. (For reference, the UK banking system was operating with a CET1 capital ratio of 12% at the end of Q3.)

Points worth noting

But two points are worth noting. Any increase in the CCB is likely to be very gradual – the banks will have one year to comply with any change in the CCB, which itself is likely to be far smaller than the 1pp in the first instance. More critically, though, the FPC made clear that this would not necessarily lead to any increase in the size of actual capital buffers for individual banks since the PRA plans to reduce so-called “capital planning buffers”, a stop-gap measure brought in before the strategy for using the CCB was outlined. The implication is that at least for now there will be little to no overall increase in the capital that banks are required to hold – and as a result no net tightening in credit conditions that may arise from regulatory pressure. Indeed, the material released by the Bank – by clarifying that the quantum of capital expected by regulators in the ‘steady state’ is now very close to the actual level of capital in the system – may actually enhance banks’ willingness to lend today. Baseline projections, published in the FPC’s annual stress tests, show that CET1 capital ratios are set to rise above the level the committee will ultimately demand. This could imply balance sheet space that banks will use to increase their risk assets over time.

Changing view

Thus, the case for altering one's view of the desired monetary policy path given the Autumn Spending Review or the FSR is limited. Any change will therefore have to be driven by changes in one's perception of inflationary pressures over the medium term. In summary, the weight of evidence does not suggest that the case for a 25bps rate hike has been undermined.

Global expansion is sluggish

Global expansion remains sluggish and risks to the pace of UK export growth are to the downside, most obviously from a sharper slowdown in the Chinese economy. Indeed, one cannot rule a more malign period of financial turmoil, driven by the unwinding of excessive debt in China. But demand growth in advanced economies looks solid, supported by the real income gains resulting from the collapse in commodity prices. Encouragingly, the pace of expansion in Britain's major trading destination, the euro area, appears to be picking up on the back of robust private sector demand in Germany, and increasingly, the two largest periphery countries, Spain and Italy.

Spending supports growth

Ultimately, though, it will be spending by UK households and businesses that support UK growth in the next few quarters. If anything, news about developments in the recent past has been a little disappointing (albeit relative to optimistic expectations). Retail spending (in volume terms) looks broadly flat in the current quarter; car sales have fallen back. And when it comes to the wide array of survey evidence at our disposal, a fairly uniform picture of output growth close to its trend rate (of around 2%) emerges. This pace of expansion is half what was seen in H1 2014 and a little slower than that previously anticipated. To the extent these data tell us something about likely RGDP growth through 2016, there might be a case for keeping monetary policy unchanged.

Policy must be forward looking

But ultimately policy has to be forward-looking. It takes some while for monetary policy changes to filter into broad monetary conditions and at one further remove nominal demand. Moreover, one has to be cognisant of the fact that the 'neutral' policy setting may itself be changing, involving a higher policy rate as we move further from the Great Financial Crisis. In that sense, increases in Bank Rate (or indeed gilt sales) may not actually 'tighten' monetary conditions, the ultimate aim of efforts to withdraw monetary stimulus.

A broad array of monetary indicators

There is no single variable that captures the 'monetary conditions' that matter for nominal demand growth. One has to consider a broad array of variables that capture the private sector's access to purchasing power, both in quantity and price terms. When such an analysis is conducted, the conclusions are notably more positive than that which follows from a detailed examination of the official/survey data capturing current economic conditions. This matters because 'monetary conditions' should be a lead indicator of trends in nominal demand.

M4 growth is consistent with solid NGDP growth

Published broad money growth is currently running at 4½% (on the M4ex measure). Given underlying forces likely to be pushing up on money velocity (at least relative to the pre-crisis trend), such a rate appears consistent with solid NGDP growth and target inflation. It should be noted, however, that the UK private sector holds £130bn of National Savings & Investment (NS&I) deposits, which are excluded from the M4ex measure. Since these are quite clearly monetary assets of the private non-bank sector, they should be taken into account. Flows into NS&I accounts have been considerable in the last twelve months, reflecting high demand for the Chancellor's 'pensioner bonds'. Once these are counted, broad money growth is around 1 percentage point higher. Also of note is the fact that money balances of the non-financial private sector, which are potentially more relevant for nominal spending growth, are growing even more quickly than broad money overall (at 6½% in the year to October).

Strong growth in credit volumes

Unused credit facilities also represent an important source of liquidity for firms and households. Analysis of Bank of England data shows that they have been growing rapidly over the last year (up 7% in the year to October) and in particular since the spring. Annualised growth since April has been 13%. To the extent that credit facilities are provided to customers in advance of the credit being drawn, this could suggest stronger growth in credit volumes (and monetary growth) in the months ahead. Consistent with the idea of robust growth in bank credit supply (the critical driver of credit and monetary conditions), lending spreads across many product lines continue to decline, especially for higher risk mortgages and loans to SMEs.

Spare capacity is shrinking

Overall, monetary conditions appear supportive of robust (private sector) demand growth, quite possibly demand growth at a rate consistent with above-trend output growth in 2016 and hence a further reduction in spare capacity within the economy. Given statistical estimates of the output gap, but more importantly, evidence of growing recruitment difficulties within the labour market, the argument for a gradual withdrawal of monetary stimulus seems sound, hence the call to hike Bank Rate to 0.75%. Barring the crystallisation of downside global growth risks, it is likely that additional Bank Rate hikes will be warranted as we move through next year.

Vote and comment by Anthony Evans

(ESCP Europe Business School)

Vote: Hold Bank Rate.

Bias: Raise.

Economy performing well

The economy is performing well enough not to warrant emergency interest rates, and continued low rates are generating misallocations of capital. However policy makers need to be consistent and credible, and therefore whilst consumer prices remain so far below target (currently at -0.1%) and with no evidence of runaway inflation, the policy stance should be unchanged.

Beneficial supply side shock

It is important to stress that the reason for present deflation is beneficial supply side shocks, and monetary policy is denying households the increases in real income that should occur. This provides a strong argument to consider alternatives to inflation targeting, especially those that consider a broader range of asset prices.

Vote by Andrew Lilico

(Europe Economics)

Vote: Hold Bank Rate.

Bias: To raise rates.

Vote and comment by Patrick Minford

(Cardiff Business School, Cardiff University)

Vote: Raise Bank Rate by ½%. Start to reverse QE.

Bias: To raise Bank Rate and QE to be reversed.

Economy still doing well

The UK economy has continued to grow well, at between 2.5 and 3%, with the latest figures for growth coming in closer to the bottom of this range. Third quarter house price growth also came in a bit weaker than we expected last quarter. We can attribute this also partly to the ‘macro-prudential’ controls exerted on housing via the guidance to the banks on mortgages etc.

Uncertainties persist

Looking ahead, we find that much commentary stresses the uncertainties of the world environment, and especially of China. Yet the most dramatic world developments are in commodity prices and these are encouraging for the continuation of the world’s general, if so far slow, recovery from the recent crisis. Commodity prices have collapsed, as frequently happens at this stage of the world cycle. They are fuelling ‘deflation’, but this is ‘virtuous’ because it represents a huge tax cut from producers for consumers. The way this works is that producing countries can do little except borrow their way through their cash collapse, while consuming countries find profits and real incomes rising, stimulating investment, consumption and innovation.

China slowing but no world recession

In spite of its grim overhang from the investment splurge of 2009–10 China is also participating in this tax-cut environment. Consumption and services investment are growing strongly even as manufacturing investment is being cut to reduce excess capacity. The US is growing well if not in the traditional V-shaped recovery. Even the euro-zone is now recovering; its recession was recently dated by the euro business cycle group as having ended in early 2013. Also, as one looks around the emerging market economies most are growing respectably if not joyously. So China is slowing; but the world is not going into recession. The UK’s recovery has support in the rest of the world – and the strengthening of the euro-zone is particularly welcome.

House price forecasts

This month we have done in Cardiff a forecast for housing. It remains positive, with house prices set to rise around 7 % a year until the end of the decade. This can be thought of as the process of real house prices (i.e. prices corrected for general inflation) returning to their long

run trend, which shows growth of around 3% a year. Being somewhat below trend, prices need to catch up by growing a bit faster than this for a time.

Scenarios

However, more interesting than our main forecast is a variant we have done on a policy of endless 'zero' interest rates. Mr. Carney has suggested that the indefinite postponement of a rate rise is on the cards but that if so the Bank will use 'macro-prudential' methods to stop for example a housing boom. According to our model, these micro-controls will not have any effect, other than some displacement of price rises over time which we cannot model. This policy therefore results in some pretty sharp house price rises, faster growth and more inflation.

A credit boom is possible?

In this scenario GDP growth picks up strongly to well over 3% and inflation also increases, to 3% by 2018; however it does not increase so much that it stops the policy, given the inflation target background. So the scenario mirrors what one might call a credit boom in which the inflation target manages to remain credible and so keep a lid on wage and price increases. How long this could continue is clearly quite uncertain; but we had some such developments in the decade of the 2000s until the crisis. So it is something of a repeat of recent history.

House prices might boom?

In this scenario we get another house price boom, with prices rising over 10% a year, well above inflation still around the 2% mark – hence real house price growth over the 8% mark. This scenario should be something of a warning to policymakers that it is only too easy, after a period of recession, to allow policy to react by being excessively loose, through fear of 'stopping the recovery'.

Policy should be tightened

As before, my view is that monetary policy should move to normality at once, with gradual rises in rates (in steps of 0.25% starting at once) and elimination of QE. Simultaneously bank regulation should be relaxed, as appears to be happening

Vote and comment by David B Smith

(Beacon Economic Forecasting)

Vote: 1/8% rise in Bank Rate.

Bias: To raise gradually and in small steps.

Disappointing Autumn Statement

For people who believe in frugal government, and that free markets unencumbered by excessive tax and regulatory burdens provide the only guarantor of future prosperity, Mr Osborne's 25th November Autumn Statement was a disappointment. This is especially so, as the first spending initiative of a new Parliament provides an unrepeatable window of opportunity for taking unpopular but essential measures. This opportunity soon vanishes as politicians look forward to the next general election or, perhaps, a contest for the leadership of their own political party. Unfortunately, the Chancellor appears a regular recidivist where announcing tight spending targets, but then failing to achieve them, is concerned. Once public sector unions and similar vested interests suspect that Mr Osborne's resolve crumbles when put under pressure – and the financial markets realise that the Chancellor has been better a 'talking the talk' than 'walking the walk' where parsimony is concerned – the government's fiscal credibility could suffer badly. This is especially important given the extent to which the Autumn Statement arithmetic relies on low debt servicing costs, as well as possibly questionable assumptions about the future tax take.

Mr Osborne's 2020-21 spending target a necessary condition for fiscal sustainability

These comments do not mean that the Chancellor's declared intention to take the general government spending ratio as a share of market-price GDP down to 36% by 2020-21, compared with 40.7% in 2014-15, is not a worthwhile objective. However, the market-price measure of GDP is not a particularly useful scaling factor, because it is gross of indirect taxes and goes up whenever these imposts are raised; for example, the hike in VAT to 20% announced in 2010. Using the superior factor-cost measure of GDP, which nets out indirect taxes and provides a better measure of the resources taken up by the state, the government spending ratio is forecast to fall from 46.3% in 2014-15 to 40.9% by 2020-21.

But his track record suggests that it will not be achieved

Statistical evidence suggests that the upper limit on taxable capacity is around 37.3% of the market-price measure of GDP for the developed countries as a whole, as represented by the aggregate OECD area using annual data for 1970 to 2014. Increasing government spending beyond this point appears to cause a one-for-one increase in government borrowing. Where Britain is concerned, the upper limit of non-oil taxable capacity appears to be around 35.5% of market-price GDP. However, the government has non-tax revenues amounting to a couple of percentage points of national output, implying that the upper limit to revenue capacity in both the OECD in general, and Britain specifically, is broadly similar at around 37% to 38%. This analysis suggests that Mr Osborne's 36% 'general-government spending / market-price GDP'

target for 2020-21 is reasonable and also necessary given the huge increase in government debt in recent years. However, any rational gambler would look at Mr Osborne's track record and bet against this target being achieved in reality, unless the odds were incredibly favourable.

Monetary implications of the Autumn Statement

On balance, the Autumn Statement implies that British monetary policy needs to be tighter than would have been the case if Mr Osborne had stuck by his earlier spending proposals. This is not just because of Keynesian concerns about the potential demand-side effects of the spending slippage, and HM Treasury's revealed unwillingness to accept political pain up front to achieve longer-term economic benefits, but also because of the supply-side damage caused not just by increased government spending in general but also by some of Mr Osborne's more specific measures. Both the living wage and the apprenticeship levy will impact on corporate profitability and reduce the incentives to invest and undertake business risks. Such measures also make it more difficult for the labour market to clear and risk a rise in the unemployment rate consistent with stable inflation, which would make the official interest rate setters' task more difficult.

Should the BoE wait for the US Fed?

More immediately, there is the question of the forthcoming 16th December meeting of the US Federal Reserve, where there seems to be a reasonable probability of a rate increase for the first time since the Global Financial Crisis. There is no reason in logic why the Bank of England should wait for its US counterpart to go first, when it comes to raising rates. That is, unless there was a concern about the short-term impact of an early UK rate rise on the sterling/US\$ exchange rate, although the foreign exchange markets would need to be non-rational for this to be the case. However, as a breed, central bankers generally do not like to go out on a limb, the US Federal Reserve is still the pre-dominant player in international financial markets, and it is unlikely that UK Bank Rate will actually be raised on 10th December.

Shivering besides the pool

However, there is also a risk that central bankers are coming to be regarded as akin to primary school children shivering at the side of a possibly cold swimming pool but afraid to jump in. This concern already appears to be undermining the credibility of the US Fed. However, central bankers have made a rod for their own backs by holding rates down for so long. The main reason is that the psychological barriers to a rate hike, and the trauma when one occurs, tend to increase with the passage of time. This is an uncertain world and it is easy to sympathise with the view that a rate increase would cause an undue psychological shock to business and the financial markets. As a consequence, it is important that any rate increase should be introduced in a way that does the minimum damage to economic confidence. However, interest rates will inevitably have to rise at some point. In addition, the UK labour market appears to be approaching the point where hitherto quiescent

wage demands become more aggressive. It is now time to put down a marker and raise UK Bank Rate by a modest 1/8% while indicating that any further tightening will be done gradually and in small steps. Sometimes, jumping into the water early – but with appropriate caution – is better than an open-ended period of shivering at the pool side.

Vote and comment by Peter Warburton

(Economic Perspectives Ltd)

Vote: Raise Bank Rate by ¼%.

Bias: To raise rates in stages to 1½%.

Painful normalisation of public finances

Amid the excitement surrounding the vague possibility that, one day, UK interest rates might normalise, it is easy to overlook the painful shortfall in the normalisation of the public finances. This was highlighted again by the recent publication of the Autumn Statement and the Comprehensive Spending Review. Since July, total managed expenditure has been upgraded by between £12bn and £20bn per annum for every year from 2014-15 to 2020-21. (Only £3bn to £4bn per annum of this is attributable to the change in accounting treatment for housing associations). The most significant source of ‘funding’ for these spending increases is benign interest rate assumptions stretching throughout the forecast horizon.

Output gap has now closed

Those who invest great significance in the output gap concede that it has now closed. Ergo, the almost 5% of GDP budget deficit that remains must be regarded as wholly structural. Seven years on, the UK remains far away from fiscal normalisation. These two dimensions of incomplete – or indeed scarcely commenced – policy adjustment have been extremely influential in the evolution of the national balance sheet.

Yields have fallen

Extreme monetary accommodation and financial repression have whittled away the yields on bank deposits and government bonds and propelled a search for alternative sources of income yield in more dangerous contexts. Fiscal forbearance has provided free social insurance to the household sector and, in a few cases, subsidies to the corporate sectors. The phase of aggregate improvement in the national balance sheet ended in 2013. While households and non-financial corporations present a healthy picture in the round, deep divergences of recent experience lie beneath the surface.

Financial repression

The gild has worn off the lily for financial corporations as banks and insurance and pension companies labour in a low interest rate and compressed profit margin environment. While financial repression subdues government’s debt service payments and hence lowers the budget deficit, the government’s balance sheet is doubly disadvantaged by weak growth in nominal GDP and very low interest rates. The

non-financial private sector has been gifted the asset revaluations to restore and embellish its net worth ratio but the financial sector is bearing an increasing burden of future liability. The plan to eliminate the government deficit is now enshrined in law but still written in pencil. No repair of the government balance sheet is in sight.

UK balance sheet damaged

The temptation in discussing developments in the national balance sheet is to ascribe the major shifts to changes in behaviour on the part of households, firms or financial institutions. In reality, it is movements in interest rates and asset prices that rule the roost. The recovery in the household balance sheet from the depths of 2008 has largely been accomplished as a consequence of the rebooting of equity prices that started in March 2009 and the revival of house prices from 2013. While there was an interval, 2009-12, in which the household saving rate spiked higher, asset revaluations have dominated.

Policy intervention

What are the implications of this analysis? First, that policy interventions have reflat asset prices to give an appearance of balance sheet normalisation in the non-financial private sector. This has provided a sufficient source of comfort that households - or at least the ones that are most responsible for voluntary saving - feel less need to do so. The UK economic recovery has continued to rely proportionately on the growth of household consumption. If the elevated structure of asset prices - bonds and equities - ceases to be underwritten by policy promises, then we should expect the wealth ratio to fall, the saving rate to rise and the contribution of household consumption to weaken. Second, the lack of recent progress in reducing the structural budget deficit leaves the UK vulnerable to a scenario in which the debt service burden normalises at a much higher ratio to GDP: 5%, rather than 3%. The pressure that this would place on UK public finances in the medium term would surely have adverse implications for Gilts and Sterling.

UK balance sheet damaged

George Osborne is a clever Chief Financial Officer, who has navigated the financial, economic and political currents with skill. However, the national balance sheet has been damaged by this cleverness. The government and the financial sector are carrying heavy additional liabilities in a low interest rate environment. The lack of reflation of the broader economy is keeping debt ratios from making the adjustment necessary to steady the fiscal ship. Far from entering a serene 'new normal', the UK economy still carries the risk of repeating some of the turbulence associated with the 1970s.

Time to raise interest rates

Far from being a kindness, repressed interest rates are responsible for distorted behaviour and accentuated redistributions. The path to higher interest rates may not be smooth, but it is the only path to sensible resource allocation in the medium-term. The opportunity to start this journey was presented as long ago as early 2013. Better late than never to raise interest rates.

Vote and comment by Mike Wickens

(University of York)

Vote: raise bank rate by 0.25% and decrease QE to £250bn.

Bias: start to unwind QE and slowly raise interest rates as the economy grows.

How does the MPC react to fall in sterling?

The new dilemma facing the MPC's interest rate decision is how to respond to likely changes in the value of sterling. The Fed is widely expected to raise its interest rate this month and thereby put upward pressure on the dollar and the ECB is expected to decrease its interest rate and so further depreciate the euro. Should the MPC align interest rates with movements in the dollar or the euro? Previously I have expressed the view through the Shadow MPC that the MPC will not raise rates unless the Fed does. So far this prediction has not been rejected, but will and should the MPC raise rates if the Fed does?

Assumption that inflation is due to demand

The fundamental problem that has faced the MPC for a number of years is that using interest rates to control inflation is based on the assumption that inflation is due to demand shocks. For example, rising inflation is attributed to positive demand shocks. The policy response to this is higher interest rates. In recent years we have seen falling and persistently low inflation which no amount of monetary loosening has been able to influence. This has been caused, not by negative demand shocks, but by positive supply shocks, in particular, falling commodity prices. Added to this, a debt-driven recession and the rebuilding of balance sheets have lowered both expectations of a quick recovery and a willingness to invest.

Consumers and industry have benefited from fall in prices

Nonetheless, both consumers and industry have benefited from this reduction in costs, especially fuel costs. As a result the UK economy is now growing again at a trend rate of growth. It doesn't therefore need a monetary stimulus or even a continuation of the MPC's expansionary monetary policy even though inflation is still below target at 1.7 percent.

Focus on inflation

Since 2009 UK inflation has been driven by falling commodity prices, largely determined in US dollars, and the strength of sterling, which has contributed to a UK current account deficit since 2012 in excess of 4 percent of GDP and a trade deficit for the last 10 years between 2 and 3 percent of GDP. A dollar appreciation is likely to cause commodity prices to rise thereby raising UK inflation. Euro depreciation is likely to reduce UK exports to the EU, still our main market. This would negatively impact on the demand for UK goods and services and, in anything, reduce demand pressures on inflation. If the MPC seeks to raise UK inflation to its target level then it is clear what the MPC should do. It should not raise its interest rate in response to an increase in US rates. It should allow imported inflation from commodity prices to rise and maintain the EU demand for UK exports.

Commodity prices helped UK

Nonetheless, in my view this would be a mistake. This is because the broader benefits from low commodity prices have served the UK well as they have reduced costs, which has stimulated domestic demand, and offset the strength of sterling through improved competitiveness.

Problem with the mandate

All of this reveals a fundamental problem with the MPC's inflation mandate that arises from the presence of supply shocks. Tightening monetary policy when inflation rises due to negative supply shocks would be likely to magnify the negative effects on output. And loosening monetary policy in order to raise inflation may cause a negative supply shock due to the effect on the exchange rate. Currently, the MPC is likely to be facing the latter situation if it allows UK monetary policy to become looser than that of the US.

Vote by Trevor Williams

(Lloyds Bank Commercial & Derby University)

Vote: Hold Bank Rate.

Bias: Neutral.

Policy response

1. On a vote of five to four the committee agreed to raise Bank Rate to 0.75%.
2. Of the five that voted for an immediate rise, two voted for a rise of $\frac{1}{2}\%$, two for $\frac{1}{4}\%$ and one for an increase of one-eighth. Therefore, on our voting methodology, the vote was for a rise of $\frac{1}{4}\%$.

Date of next physical meeting

Tuesday, 12th January 2016

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. The present note summarises the results of the latest monthly poll, conducted by the SMPC in conjunction with the Sunday Times newspaper.

Current SMPC membership

The Secretary of the SMPC is Kent Matthews of Cardiff Business School, Cardiff University, and its Chairman is Trevor Williams (Lloyds Bank Commercial Banking and Derby University). Other members of the Committee include: Roger Bootle (Deloitte and Capital Economics Ltd), Tim Congdon (International Monetary Research Ltd.), Jamie Dannhauser (Ruffer), Anthony J Evans (ESCP Europe), John Greenwood (Invesco Asset Management), Graeme Leach (Legatum Institute), Andrew Lilico (Europe Economics and IEA), Patrick Minford (Cardiff Business School, Cardiff University), David B Smith (Beacon Economic Forecasting), Akos Valentinyi (Cardiff Business School, Cardiff University), Peter Warburton (Economic Perspectives Ltd) and Mike Wickens (University of York and Cardiff Business School). Philip Booth (Cass Business School and IEA) is technically a non-voting IEA observer but is awarded a vote on occasion to ensure that exactly nine votes are always cast.



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