# Shadow Monetary Policy Committee

16th December 2018

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

In its December 2018 e-mail poll, the Shadow Monetary Policy Committee (SMPC) elected, by a vote of six to three, to hold rates in December. The three favoured a 0.25% rise.

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 noted that the UK economy continues to grow steadily, unemployment is low, and 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 by Philip Booth

**(St Mary University, Twickenham)**
**Vote: No change.**
**Bias: To tighten.**

### Vote and comment by John Greenwood

**(Invesco Asset Management)**
**Vote: No change in rates, but the Bank should conduct open market purchases to expand money growth.**
**Bias: None.**
The M4x money growth rate at 2.6% year-on-year in October (down from 5.2% in January 2018) is too low. (The broader M4 was only 1% year-on-year in October, also too low.) Irrespective of the outcome of Brexit, if M4x growth rates remain as low as this for a sustained period, inflation will considerably undershoot the 2% target. The Bank therefore needs to ease lending conditions and/or consider doing additional QE.

### 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.**
The latest M4X figures still show a very sluggish annual rate of growth of money (2.6%, October 2018 data). What it is more worrying is that the Bank of England seems to be running off of gilts in its portfolio (indeed the assets purchased by the Bank of England through QE mainly from 2009 to 2012). It is not clear yet whether this is an intentional policy of the Bank. Be that as it may, if bank lending to the private sector does not pick up, this means broad money growth will continue to decelerate in the next few months. As a result, there should not be inflationary concerns over the medium term (end of 2019 and 2020). On top of it, greater political uncertainty about the final outcome of the 'Brexit deal' with the EU adds another reason to be cautious and hold rates.

### Vote and comment by Julian Jessop

**(IEA)**
**Vote: No change**
**Bias: to Raise**

This is (hopefully) the moment of peak Brexit uncertainty. There is a case for continuing to raise rates anyway as a vote of confidence in the medium-term prospects for the economy, especially with the labour market continuing to tighten. But the latest monthly GDP data and business surveys have been weak and sentiment in fragile, suggesting that a brief pause is now justified.

### 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%**
Interest rates remain excessively low, and such low interest rates have, for some time, damaged productivity growth and hence the medium-term sustainable growth rate. Normalisation of interest rates is a central requirement to restoring more rapid medium-term growth. The concept that we need to establish more rapid economic growth for a sustained period before we can raise rates gets the

matters exactly the wrong way round. The rates affect the growth. Higher rates will mean higher growth, provided they are raised in a gradual and non-disruptive way.

### Vote and comment by Patrick Minford

**(Cardiff Business School, Cardiff University)**
**Vote: Increase Bank rate by ¼%**
**Bias: Raise further, reverse QE (QT) gradually.**

### 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**

There is an urban myth circulating that although the official UK unemployment rate is very low, under-employment is rife and remains worse than in 2008. This misrepresentation of the data is then adduced in explanation of the weak pace of average wage inflation. While the undeniable erosion of labour market tenure has provided a structural headwind, the potential for wage inflation to respond to a tightening market is undiminished.

The disintegration of the labour contract since the 1980s is a worthy topic of study, but we must not confuse the relative insecurity of employment with the relative strength of the jobs market. Most people on zero-hours contracts do not work zero hours! Similarly, the recorded desire of part-timers to work full time must be tested against their capability and commitment to do so. Both of our derived measures of the overall degree of labour market under-utilisation, one in terms of total weekly hours worked and the other in terms of full-time equivalent employment strongly suggest that this is the tightest labour market since the onset of the 1980 recession.

Annual average earnings inflation has already risen significantly in the construction, information and communications and hospitality sectors. The latest monthly labour market report, referring to the 3 months to October 2018, carries a 3.3 per cent annual growth rate for whole economy average earnings in the context of another strong employment report. Headcount employment is up 1.7 per cent on a year ago, employment of full-time and part-time staff is 2.3 per cent higher and weekly hours worked is also up 1.7 per cent. The employment rate is at a new record, 75.7 per cent.

The tightness of the labour market should have emboldened the Bank of England's MPC to crack on with interest rate rises long ago. It is irresponsible to assume that Brexit-related traumas will take the sting out of UK inflation in 2019. Indeed, there is a good chance that business fixed investment will recover when uncertainties subside. In contrast to the ill-considered August 2016 Bank of England playbook, the bias in the post-Brexit should be towards higher interest rates across the yield curve.

UK monetary trends remain subdued, but not unduly worrying. The Bank of England Monetary Policy should be emboldened by the resilience of the real economy this year 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 made as soon as possible.

### Vote and comment by Trevor Williams

**(University of Derby)**
**Vote: Hold Bank Rate**
**Bias: None**

Money supply growth has slowed fast and implies - if it stays at these rates - that inflation will fall below target in due course. Accompanying this will be slower economic growth as we go into 2019. Employment growth is already easing and productivity gains are harder to come by.

## 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

15 January 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. 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 Rotating Chairman is Trevor Williams (University of Derby). 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 (IEA), 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).