INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Monetary Policy Committee meeting, Bank of England, 16th December 2021

Bank of England raises base rates

After raising expectations of that it would tighten monetary policy at its November 4th meeting but then doing nothing, the Bank of England's Monetary Policy Committee finally voted by 8 to 1 at its meeting on 16th December to raise base rates from 0.1% to 0.25%. The reasons why lone dissenter Silvana Tenreyro voted against a rate rise were concerns about the effect of the Omicron variant on the economy and also a lack of conviction that the UK recovery was sufficiently solid. (GDP grew by only 1.3% in the third quarter of 2021, following growth of 5.2% in Q2). After the November meeting, Governor Andrew Bailey had stated that the decision not to raise rates then had been a "close call", but the December meeting came after the publication of the monthly inflation figures, showing that consumer prices had risen by 5.1% in the year to November, a notable increase on October's figure of 4.2%. This seems to have won over any waverers concerned about Omicron. The same day as these figures were released, a stinging article by Ben Marlow appeared in the *Daily Telegraph* criticising the MPC for wrong footing the markets by not raising rates last month, being "behind the curve" with its inflation forecasting, and "blighted by groupthink", adding that "It is hard to think of a moment in the post-pandemic recovery when they got it right....the Old Lady {*of Threadneedle Street*} is fighting for its credibility".

Even though Mr Marlow did not mention the quantity of money in his blistering attack, he rightly highlighted how the MPC has repeatedly underestimated the threat of inflation. It is the surge in broad money growth and not supply chain shortages which is pushing up inflation and although the rise in base rates may help slow it down, it raises the question as to why the MPC did not also terminate the asset purchases, introduced in 2020 to counteract the effects of the coronavirus pandemic. Broad money growth stood at 6.7% in the three months to October. This is too high in a developed economy to be compatible with an inflation target of 2%. The asset purchases are scheduled to end in early 2022, which should help bring broad money growth down to more acceptable levels, but with the time lag between a surge in broad money and rising inflation sometimes being as long as 18 or 24 months, high inflation is likely to persist in the UK for much of 2022. The MPC acknowledged this, predicting a 6% peak in April 2022. However, it could have dampened inflation down sooner by ending the asset purchases forthwith. The logic of raising base rates to curb inflation while at the same time continuing with "Quantitative Easing" which will make it worse is rather hard to follow.

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