INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Monetary Policy Committee meeting, Bank of England, 17th March 2022

Bank of England raises bank rates for the third time in a row

On 17th March, the Monetary Policy Committee of the Bank of England voted by 8 to 1 to raise the Bank Rate by 0.25% to 0.75%. This was the third consecutive announcement of a rate rise following an MPC meeting. Interest rates are now at their highest level since the Global Financial Crisis of 2008-9, when rates were cut from 5% to 0.5%. The press release following the meeting indicated concerns that events in Ukraine could cause the current inflationary spike, which the Bank previously expected to peak at just over 7% in April, to rise still higher as a result of the upward pressure on energy prices and the potential for further supply chain disruptions.

While in the immediate future, these predictions are likely to be correct, inflation may come down more quickly than the Bank of England expects because it is the *quantity of money*, broadly defined, not supply chain issues, which is the prime determinant of inflation. A number of factors point to broad money growth falling sharply this year. The rise in the bank rate is likely to impact the housing market in particular. Many households, already squeezed by higher energy bills, rising food costs and the increase in National Insurance, are unlikely to consider taking out new mortgages and may struggle to manage existing repayments as rates are raised. There has been little growth in the advance of new bank credit to businesses in recent months and higher borrowing costs will do nothing to alleviate this situation. Last December, banks were required to raise their countercyclical capital buffer by 1%, which can only result in their being less willing to build up their portfolio of loans and on top of this, the Bank of England has already started the "run off" of its stock of government bonds, as announced at February's MPC meeting. Approximately £28b. of these bonds have matured and the money will not be reinvested – in other words, money has been destroyed.

Between them, these developments are contractionary as far as broad money growth is concerned. In the three months to January, M4X grew at 3.6%, the slowest rate of increase since the outbreak of the coronavirus pandemic two years ago. The growth rate is likely to fall further, especially as the MPC stated that "some further modest tightening in monetary policy may be appropriate in the coming months" because of its worries about the level of inflation. While it is good that the Bank of England has not attempted to relax its official 2% inflation target, the Bank of England is now in real danger of tightening monetary policy too quickly and provoking a recession in 2023-4.

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