INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Monetary Policy Committee meeting, Bank of England, 16th June 2022

Fifth increase in the Bank Rate

On 16th June, only a day after the US Federal Reserve raised the Fed Funds Rate by 0.75%, the Monetary Policy Committee of the Bank of England voted by 6 to 3 to raise the Bank Rate by a further 0.25% to 1.25%. This was the fifth consecutive announcement of a rate rise following an MPC meeting. In a repeat of the voting pattern in May's meeting, the three dissenters wanted a larger (0.5%) increase. Interest rates are now at their highest level in 13 years and further rate hikes may follow. The statement issued after the meeting made it clear that if inflation proves persistent, the Bank would "if necessary act forcefully". Consumer price inflation hit 9% in the year to April and the Bank is perhaps being somewhat more realistic in its assessment of inflationary prospects in the coming months than some other central banks. A peak of just over 10% is anticipated in the final quarter of this year.

The statement contained an analysis of what the MPC believes to be the underlying causes of inflation. Global energy price shocks and the war in Ukraine are both mentioned, along with the tight domestic labour market. Conspicuous by its absence is any mention of the surge in broad money growth in 2020 which the Institute of International Monetary Research has consistently identified as the main cause of the current inflationary surge. There is a danger that the exclusion of money from its considerations will cause the MPC to adopt a policy which will cause M4X to contract and thus lead to a recession within two years. In April itself, UK broad money grew by only £1.1b., the second lowest monthly reading since September 2018. Besides increasing the bank rate (which inhibits the creation of new bank loans and thus the creation of deposits, which are money), the BoE is also actively reducing its balance sheet. Assets purchased in 2020/21 to the value of £3.2b. mature in July and the money from these will not be reinvested. This action will further slow broad money growth.

The MPC reiterated its determination to return inflation to its official 2% target. In the short term, today's rate hike is unlikely to have much effect on consumer prices, but could intensify the slowdown in the economy that is already becoming apparent. The UK economy contracted in both March and April and the current trajectory of UK monetary policy is making a recession increasingly likely.

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