INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Monetary Policy Committee meeting, Bank of England. 2nd February 2023

Bank Rate increased by a further 0.5%.

The Bank of England's Monetary Policy Committee decided to raise the Bank Rate by 0.5% to 4% at its meeting on 2nd February. This is the tenth consecutive increase in borrowing costs, which have now risen to their highest level since 2008. The vote was not unanimous. Two of the nine members of the MPC voted to leave rates unchanged at 3.5%. The summary of the MPC's deliberations include an admission that the current high level of inflation had persisted for longer than expected. Consumer prices rose by 10.5% in the year to December, the second month of decline after October's reading of 11.1% but still significantly above the BoE's 2% inflation target. The MPC hinted that a further rate rise may follow, although the general tenor of the minutes of the meeting suggested that this series of increases to the Bank Rate may soon be drawing to a close. The MPC acknowledged that the UK economy is starting to slow. The housing sector in particular is showing signs of strain as a result of increased borrowing costs. Only 35,612 mortgages were approved in December, less than half of August's total of 74,425. Even allowing for seasonal fluctuations, this is a significant slowdown.

Unusually, the minutes made mention of the quantity of money. The financial sector borrowed £67b. in September to "short sterling" in the wake of the Truss/Kwarteng "mini-budget". After Liz Truss was forced to resign, the new Chancellor Jeremy Hunt cancelled the unfunded tax cuts, the pound strengthened and much of the money was paid back. The net result is that the latest money numbers show an annualised decline of 10.3% in UK M4x broad money since September. This is obviously a distortion but a look at the half-yearly M4x growth figures shows that since June, broad money has only been growing at an annualised rate of 1.2%. Furthermore, M4x declined between October and December by more than it grew in September. This indicates that broad money growth is slowing sharply even if one ignores the extreme fluctuations caused by the Truss/Kwarteng mini-budget and its aftermath. Unlike the USA, where both the central bank and many leading commentators expect the country to escape a recession, the BoE's assessment of the UK's economic prospects is distinctly downbeat. The money numbers suggest that they will probably be correct. Large businesses are still applying for new credit from the banks but the household sector and SMEs are feeling the pinch. The retail sector is now recording both year-on-year and month-on-month declines in sales. The BoE continues slowly to unwind its stock of asset purchases and has brought in a 1% counter-cyclical buffer for UK banks, which will rise to 2% in July 2023. This is a requirement for banks to hold additional capital as a cushion against losses in the event of an economic downturn. Banks therefore will have less money available for lending. The short term outlook is that real money balances will decline as broad money growth stagnates and inflation remains above target. Such a scenario almost inevitably presages a recession.

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