INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

Monetary Policy Committee meeting, Bank of England. 23rd March 2023

Bank Rate increased by a further 0.25%.

The Bank of England's Monetary Policy Committee decided to raise the Bank Rate by 25bps at its meeting on 23rd March. This is the eleventh consecutive increase in borrowing costs, which have now risen from 0.1% to 4.25% since December 2021, the highest level since 2008. Once again, the vote was not unanimous. Two external members of the nine-person MPC voted to leave rates unchanged at 4%. However, the BoE also made it clear that it is prepared to raise interest rates again if it sees evidence of "more persistent" inflationary pressures. Market pricing implies that UK interest rates will peak at 4.5% in August. The summary of the MPC's deliberations indicate a recognition of the problems experienced by the Silicon Valley Bank in the USA and Credit Suisse in Switzerland alongside ongoing concerns about the high levels of consumer price inflation in the UK. The MPC stated that UK banks are "resilient" and "well placed to continue supporting the economy in a wide range of economic scenarios", and it clearly feels as concerned about the persistence of higher costs in consumer prices. Inflation rose to 10.4% in the year to February, higher than January's reading of 10.1% and also higher than the 9.9% forecast by the BoE. The Bank also indicated that it no longer expects the UK to experience a technical recession this year. A modest increase of 0.3% in GDP in January allowed the MPC to be cautiously optimistic that the UK economy will grow, albeit modestly, in the first part of the year in spite of its tightening of monetary policy. The money numbers do not present such a positive picture. UK M4x increased by £33.7b. in January, but this was driven by significant borrowing by the financial sector. The new credit is usually paid back in subsequent months and if the activities of the financial sector are excluded, broad money growth is very weak. Lending to businesses is declining on both an annual and annualised quarterly basis, particularly the SME sector. The number of new mortgage approvals has fallen from over 74,000 in August 2022 to 39,637 in January 2023, the lowest level of approvals since January 2009 (32,400). Average UK house prices increased by 6.3% in the 12 months to January 2023, down from 9.3% in December 2022, according to the ONS. Data released by the ONS a day after the MPC meeting also show that retail sales rebounded fro a second successive month, increasing by 1.2% between January and February, following a 0.9% increase the previous month. For 10 out of the last 12 months, however, the high street has recorded a drop in activity.

There is little reason to expect broad money growth to pick up and when real money balances decline, the end result is usually a recession. The Bank of England has not engaged in such a drastic shrinking of its balance sheet as the US Federal Reserve (Only £49b. out of the £875b. asset purchases have been sold or run off), but it is doing nothing to encourage the creation of new bank credit. In December it introduced 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 at a time when new bank loans are likely to be the principal driver of broad money growth.

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