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Monetary Policy Committee meeting, Bank of England. 11th May 2023

Bank Rate increased by a further 0.25%.

The Bank of England's Monetary Policy Committee voted to raise Bank Rate by 25bps at its meeting on 11th May, as widely expected. This is the twelfth consecutive increase in borrowing costs, which have now risen from 0.1% to 4.5% since December 2021, the highest level since 2008. Once again, the vote was not unanimous with two external members (Swati Dhingra and Silvana Tenreyro) of the nine-person MPC voting to leave rates unchanged at 4.25%, citing the delayed effects of prior rate rises which were still to be realised. This hike in borrowing costs was widely expected given that consumer price inflation remains stubbornly high at 10.1% in the year to March. The meeting took place concurrently with the publication of the Bank's latest quarterly Monetary Policy Report, which predicted a flatlining UK economy with inflation slowing significantly after April to end the year at a revised up 5.1% - and to keep falling to its 2% target by the first quarter of 2025, a modest tightening of the labour market but importantly no recession. The report predicted that Bank Rate would peak at 4¾% later in the year before falling back to 3% by the end of 2024. Following the MPC meeting, Governor Andrew Bailey refused to be drawn about future rate rises, insisting that decisions will be guided by the evidence but admitting that inflation has been higher than expected due largely to the persistence of food price rises.

Governor Bailey and the MPC have faced considerable criticism for their inaccurate inflation forecasting over the past two years. They have made little mention of the quantity of money in their recent announcements and seem reluctant to admit that the huge asset purchases between 2020 and 2022 have been the main cause of the current high inflation, as they resulted in an extraordinary spike in broad money growth, especially during the second quarter of 2020. Most of the monetary overhang has now dissipated, so the prediction of falling inflation is likely to be correct. However, the unprecedented series of rate increases, coupled with the shrinking of the Bank's asset sheet by selling or running off these assets is now causing broad money to shrink. UK M4x declined by over £18.1b. during March. The annualised quarterly rate of growth for the first quarter of 2023 stood at a mere 2.3% while the annual growth rate fell to 1.4%, the lowest reading in over a decade.

There is very little indication that broad money growth is likely to revive in the short to medium term. The deposits created by new bank credit have been the main source of broad money growth since the termination of asset purchases, but recent months have seen a decline both in new mortgage lending and loans to businesses. The BoE's corporate bond sales are likely to cease in the coming weeks, but the run-off of maturing assets will continue, which destroy money. The increase in the Counter-Cyclical Buffer from 1% to 2% in July will inhibit new bank lending. (This regulation requires banks to set aside a certain amount of capital to tide them over in the event of financial crises.) While there has been no knee-jerk reaction to the failure of several banks in the USA and Europe, the possibility of additional banking regulation cannot be ruled out. Thus far, the effects of the decline in broad money have been mainly felt in a slowing housing market and retail sector. House prices increased by only 0.1% in the year to April, while in the High Street, sales declined on both a monthly and annual basis in March due to the squeeze on money balances. The picture painted by the money numbers suggests that the Bank of England's relative optimism is wishful thinking. Negative broad money growth combined with high inflation is the classic precursor to a recession.

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