



30th November 2008

Shadow Monetary Policy Committee E-Mail Poll: December 2008

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Cut Bank Rate by a Further 1% in December, Says IEA's Shadow Monetary Policy Committee

In its latest E-mail poll (carried out in conjunction with the *Sunday Times*) the Shadow Monetary Policy Committee (SMPC) voted that UK Bank Rate should be reduced by a further 1 percentage point on 4th December. One SMPC member wanted a Bank Rate drop of 1½ percentage points, four members favoured a cut of 1 percentage point, two argued for a ½% percentage point reduction, and two wanted to hold Bank Rate at the 3% set on 6th November. These somewhat divergent recommendations would deliver a 1% reduction according to the voting procedures employed by the Monetary Policy Committee (MPC). The initial SMPC poll was carried out before the 24th November *Pre-Budget Report*. However, the poll was re-opened on Tuesday 25th November. Five SMPC members amended their texts - but no one changed their vote - in consequence. Several members of the IEA's shadow committee were concerned about the size of the fiscal imbalances announced by Mr Darling. However, most SMPC members thought that the need to fight the meltdown in the financial sector and maintain a positive growth rate in the money holdings of the non-bank private sector had the greatest priority.

The SMPC is a group of economists who assemble once a quarter at the Institute of Economic Affairs (IEA) in Westminster. The inaugural SMPC meeting was held in July 1997. That it is the first such body in the UK, and meets regularly to discuss the deeper issues involved, distinguishes the IEA's SMPC from the similar exercises now carried out by several publications. The material that follows appears with the permission of the original authors and has not been amended by Lombard Street Research. The first E-Mail Poll of next year will be issued on Sunday 4th January 2009 while the next SMPC gathering will be on Tuesday 13th January. The detailed minutes of that meeting will be published on Sunday 1st February. A subsequent E-mail poll is scheduled for release on Sunday 1st March.

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Comment by Roger Bootle
(Deloitte and Capital Economics Ltd.)

Vote: Cut by 1%

Bias: Cut rates more

Cut Bank Rate to zero?

The economic situation is now so serious that the Bank of England should be on course to cut rates all the way to zero. Monetary policy may not be enough to save us from a deflationary depression but it should be pushed all the way. The Bank must not make the Japanese mistake of taking action too late, when deflationary expectations have set in. The question is then how to proceed from 3%. I favour another big cut which will have shock value. I suggest 1%. But even if they cut by 1% at the December meeting they should not wait long before cutting rates again.

Lower rates will help in several ways

Although lower rates will not be a panacea, and will be less effective in this environment than normal, they will help in several ways. They will have some effect on the cost of borrowing, but in addition, they will cut the cost of government finance by tending to drag down bond yields; they will thereby tend to raise the values of other assets; and they will help to raise bank profitability

Comment by Tim Congdon
(Founder, Lombard Street Research)

Vote: Hold

Bias: Neutral

Acts of faith

The lack of confidence in policy-makers is so severe that any forecast and policy prescription is an act of faith. My two main points are:

- i. The authorities must try to return to a world in which solvent banks receive lender-of-last-resort loans when they have a funding problem and are not bullied into confidence-destroying recapitalisation efforts.
- ii. If banks' lending to the private sector starts to contract and the genuine quantity of money (i.e., the money, mostly bank deposits, held by genuine non-banks) falls, the government must borrow from the commercial banks to keep the quantity of money growing at a low, non-inflationary and stable rate.

Rates are not main issue

These are the considerations that matter at present, rather than a particular view on interest rates. If you want a view on rates, it's no change for the time being and no change as my bias.

Comment by Ruth Lea
(Arbuthnot Banking Group)

Vote: Cut by ½%

Bias: To ease

Weak UK output

The fall of 0.5% in the third quarter's GDP was significantly worse than expected and presaged a nasty recession. I now expect GDP to fall by 2% next year and show only slow recovery in 2010. Unemployment (on the

claimant count measure) is now rising at around 35,000 a month and is set to accelerate as the recession progresses.

Inflationary pressures are collapsing

Meanwhile inflationary pressures are collapsing spectacularly. Oil prices have collapsed from around \$147 per barrel in the first half of July to less than \$50 per barrel. Even after allowing for the weakness of sterling against the dollar, prices have still halved from £70 per barrel in early July to around £33 per barrel. Annual consumer price index (CPI) inflation fell to 4.5% in October and is set to fall dramatically in the second half of next year. Talk is now of deflation rather than inflation, with falling prices seen as a possible deterrent to consumer spending. If, however, these declining prices are in ‘necessities’ such as fuel, food and gas and electricity bills, then hard-pressed consumers, who have experienced a real incomes squeeze for much of this year, are likely to regard falling prices as a happy respite from the squeeze rather than a signal they should defer their spending.

Money and credit conditions are tight

Money and credit conditions remain tight as banks shore up their balance sheets, reluctant to lend to businesses and individuals. Several factors are bearing down upon them – including tighter regulations, the devastating effect of falling asset prices on their balance sheets, the relative dependence on overseas institutions which are calling in their loans and the increased risks of lending to households and companies as the recession intensifies - thus intensifying the pressures on these sectors. Excluding transactions within the financial sector, the growth rate of real broad money has fallen dramatically. The economic impact of the Bank’s aggressive cuts in interest rates is inevitably blunted by the continuing difficulties in the financial sector.

***Pre-Budget Report* borrowing forecasts are unsustainable**

The Bank discussed the size of the possible fiscal stimulus in the then forthcoming *Pre-Budget Report* as one reason for not cutting Bank Rate by, at least, 200 basis points at its 6th November meeting, opting instead for a 150 basis point cut. Suffice to say at this point that the overall stimulus to the economy of £9.3bn in 2008-09 and £16.3bn in 2009-10 announced by Mr Darling was more than I had expected and the borrowing levels are unsustainable, in my view. But I would still opt for a ½% cut in Bank Rate in December, despite the irresponsible fiscal background, with a bias towards further easing in subsequent months.

**Comment by Andrew Lilico
(*Europe Economics*)**

Vote: Cut by 1%

Bias: To cut further - in due course, all the way

Deflation is now nailed on

Broad money growth is now below the rate of inflation. Oil prices now appear to be decisively below \$50 a barrel. And the break-even inflation rate for UK 2011 index-linked bonds was a negative 1.64% as of 21st November, and falling rapidly. Deflation is nailed on. The question is whether we lose control of it. Interest rate cuts should certainly be attempted - very aggressively. However, I fear that we do not have enough scope for interest rate cuts to prevent a fall into deflation, even if the monetary transmission mechanism were operating normally. Since interest rate cuts are unlikely to be converted into additional bank lending

because of financial market problems, rate reductions will be largely ineffective - as they have been over the past year.

Lower interest rates will not help households but will help re-capitalise the banks

Even were lending to increase in response to interest rate cuts, it is highly doubtful that additional private lending is desirable given the highly over-gearred position of UK households and the danger that deflation will lead to mass defaults as households become unable to service their debts. Interest rate cuts will, nonetheless, be worthwhile (assuming that banks are not overly pressured into unwise additional lending or inappropriate 'passing on' of rate cuts). This is because lower rates should enable banks to increase profitability and have some helpful cash flow and servicing-cost impact upon the lower-risk borrowers that will benefit from rate reductions.

Risks of tampering with VAT

It is perhaps worth noting that, given the near-certainty of deflation, tampering with the rate of Value Added Tax (VAT) at this time is very risky. Deflationary episodes can gather their own momentum, and if VAT reductions are indeed 'passed on' to consumers, that might tend to accelerate the slump into deflation. Given that the VAT rate has been changed (I would have vastly preferred to see income tax rebates and temporary corporation tax cuts) I would urge strongly that firms be allowed to take the effect of VAT reduction in the form of higher profits rather than being subject to political pressure to reduce prices in an already dangerously unstable situation.

Case for non-conventional monetary measures

Interest rates should be cut now by another 1%. But we should also be preparing for non-conventional (or, perhaps in some ways, more traditional) monetary policy measures. Specifically, I believe that the current legal restriction requiring budget deficits to be fully funded by debt should be removed. The urgency of readying this weapon has been enhanced by the manifestly over-optimistic growth projections in the *Pre-Budget Report* and the extremely ambitious proposals to tighten public expenditure growth - I find it difficult to believe, given the government's previous record, that a 1.1% rate of increase in total expenditure is really deliverable.

The 'printing press' should be got ready for use

I am also greatly disturbed to see that the government has persisted in its view that the sustainable growth rate of the UK economy is 2¾% - unchanged despite the epic events in financial markets, the nationalisation of the banks, plans for more restrictive regulation in the future, and a huge increase in the government's debt to GDP ratio. Can it really be credible to suggest that none of these events leads us to re-assess the trend growth rate of our economy? Overall, it seems to me that, unless taxes are to be raised substantially in what may be a low growth environment with ugly deflation, it will be necessary to monetize a material proportion of the government's annual deficits between 2010 and 2015. We do not yet need to print money to fund government deficits in order to fight deflation, but I believe that the weapon should now be prepared.

Comment by Kent Matthews
(Cardiff Business School, Cardiff University)

Vote: Cut by ½%

Bias: To ease

Depreciation of sterling reflects real factors and will not be inflationary

The 19% depreciation of the sterling effective exchange rate over the past twelve months is the combination of real and nominal factors. The collapse in domestic demand and the global downturn in international financial services have necessitated a depreciation of the real exchange rate so that the external sector can take up the slack. Admittedly it is difficult to know how much of the depreciation of the effective exchange rate is due to the change in the fundamental equilibrium real exchange rate and how much is due to current and expected monetary factors. The expected fiscal stimulus from the *Pre-Budget Report* may have contributed to the precipitous fall in the value of sterling but the drop in domestic demand has muted any inflationary implication. Whatever is announced in the *Pre-Budget Report* in the form of tax cuts, there is little chance that such a transitory increase in disposable income will do anything other than result in the repayment of debt. Spending by the private sector will remain weak. The one positive effect will be to improve the balance sheets of the banks and their liquidity position and help to reduce the spread between Bank Rate and London Inter-bank Offered rate (LIBOR). It is therefore important that Bank Rate be cut aggressively so that the fall in domestic demand does not develop into too serious a recessionary outcome.

Comment by Patrick Minford
(Cardiff Business School, Cardiff University)

Vote: Cut by a further 1½%

Bias: Subsequently reduce to 1%

Allowing Lehman to collapse was a serious mistake, which has destabilised financial markets

The events of the weeks since the unfortunate demise of Lehman have unnerved the world. Had poor Mr. Paulson understood how allowing Lehman to go bankrupt would cause him to devote many more billions of US government money to the banking sector, starting with the insurer AIG in the very next week, no doubt he would have found a way to avoid it on that fateful weekend of 13th September. At any rate the Lehman-sparked collapse in stock and money markets forced the hands of governments all around the OECD. We have seen a range of taxpayer packages to put capital into tottering banking systems - modelled mostly on that of Gordon Brown to take direct equity stakes on some sort of preference share basis.

Trembling at the cliff edge

The panic that inspired that involvement of taxpayers still echoes round the markets and the economies of the West. Like a man who has just looked over a cliff edge while clinging to the topmost ledge, they are still trembling with fear and anticipation of disaster. However, this assessment is wrong. The recession now in train is the result of a year of extreme credit tightness - perhaps the equivalent of 6% on the basic or repo rate. Businesses and consumers have cut back spending as they have found it either impossible or highly expensive to get credit.

ECB and Bank of England were behind events

During this period only the US Federal Reserve tried to offset the effects of the credit crunch by cutting interest rates drastically. Even it failed to do so totally, because of the scale of the US credit disaster. However, astonishingly neither the European Central Bank (ECB) nor the Bank of England, nor indeed most of the other OECD central banks, made much if any attempt to offset the crunch. They did so because of the commodity price boom; but they could have argued - rightly - like the Fed that this was an exogenous deterioration in the terms of trade that would lead to cutbacks in real wages and not to inflation.

Monetary policy has belatedly done enough to achieve some recovery in late 2009 or 2010

That is now history, though as a result of it there will probably be a worse recession this side of the Atlantic than in the US. What matters now is that policy has reversed engines everywhere. Interest rates are being cut sharply and the taxpayer packages are restoring confidence in bank solvency and liquidity. Already the infamous inter-bank three-month spread is coming down; in the UK for example it peaked at over 150 basis points but is now down to about 120. To get the present pattern of interest rate movements into perspective one should recall those of the last major recession of 1990-92; interest rates were raised to double digits at the end of 1988 and were kept there until the end of 1992, reaching a peak of 15% during 1990. That made four years of monetary squeeze deliberately inflicted to bring down the resurgence of inflation in 1988. Today any such 'resurgence' turned out to be a chimera and those central banks worried by it have turned tail after a year, repentantly hosing money into the economy. Hence, dire as the situation now appears to be, with recession taking hold rapidly, it is most likely that a turnaround will come during late 2009 if not before under the impact of the massive monetary loosening now going on. Initially, yes, it will not do much to thaw out the monetary freeze we have recently had, but gradually it will take effect.

Further steps to be taken

What further steps should central banks take? Base and repo rates have been cut to low levels. In the US they are down to less than 0.5%. In Europe and the UK they are around 3%. The latter can drop further and are widely expected to: 1% seems a likely resting point quite soon. However the main focus should now be on getting the inter-bank spread down. This is gradually occurring as confidence in banks returns. The process could be speeded up if central banks supply longer-term liquidity, as in the Bank's Special Liquidity Scheme, but not at penalty rates as now in that scheme, where the Bank charges the inter-bank spread whatever this may be! The object of central bank policy should be to narrow the spread; to do this it needs to charge Bank Rate for providing this longer term liquidity. After all, if the taxpayer is taking on the risk of supporting banks, what risk is a central bank taking in such lending? None at all and so it can pass on its low borrowing rate to these banks. Hence I hope to see further sharp cuts in base/repo rates to around 1% accompanied by the aggressive provision of longer-term liquidity to banks at those very same base/repo rates.

Do not 'pump-prime'

Meanwhile it is important that governments do not lose their heads and attempt large scale fiscal 'pump-priming'. There is every reason to doubt

that this will be effective as taxpayers know they will have to pay it back after a short interval through higher taxes. It therefore produces inefficient outcomes - varying taxes and wasteful spending on make-work projects. There is also a risk that some governments will generate worries about future solvency; in countries where taxpayers may be averse to higher taxes, lenders will worry that future inflation or devaluation will be used to make public ends meet. These worries would raise long-term interest rates, undoing the stimulus from monetary policy.

**Darling
measures are a
hostage to
fortune**

The latest Darling/Brown package falls short on these criteria, although HM Treasury at least managed to restrain it somewhat. It is a hostage to fortune, in the sense that if the recession lasts longer and tax revenues fall even shorter than HM Treasury has assumed, or if the bank bail-out costs the taxpayer more than the zero now projected, solvency worries would surface about the British government's finances. These would complicate the task of monetary policy, already a hard one due to past Monetary Policy Committee (MPC) incompetence. As it is, my forecasts are for a poor 2009, with a moderate recession- negative growth of 1% or less across most OECD countries. But 2010 should see a moderate recovery as monetary loosening works through. By then it will be necessary to drain money growth out of western economies once more and to push interest rates up again. My vote is for another cut in the base rate of 1.5%, with a bias to cut further to 1%; also to eliminate the risk-premium fee in the Bank's Special Liquidity Scheme.

Comment by David B Smith
(University of Derby and Beacon Economic Forecasting)

Vote: Hold

Bias: Wait and see but a tightening bias may be appropriate by this time next year

**Long and
variable policy
lags, and
synchronised
international
initiatives, give
rise to policy
over-steering
risks**

There are notoriously long and variable lags between a policy easing and its effects being felt on the wider economy. Both the scale and speed of these effects can also vary with the international background. A synchronised international easing of the sort that is now being attempted induces positive trade feedbacks from one country to another and reduces the risk that extra home demand becomes dissipated in higher imports. However, it also increases the risk of over-steering at the level of the system as a whole. By historic standards, the UK authorities have now poured a breath-taking range of monetary and fiscal stimuli into the British economy. These expansionary forces have been reinforced by the 18½% drop in the external value of sterling over the past year. If stimuli of this magnitude do not revive the patient one can only conclude that the economy is dead, arguably crushed to death by the sharply increased tax and spending burdens of the past decade or strangled by red tape.

**Stimulus may
have been
overdone**

There is clearly a risk that the stimulus has been overdone and that the UK authorities have repeated the mistakes of the British Heath administration in 1972, which was panicked by a partly weather-related rise in unemployment, did an extreme policy 'U-turn', and adopted the hyper-lax fiscal and monetary policies that led to the stagflation of the

mid 1970s. In order to minimise this danger it is important that the recent panic expansionary measures should be capable of rapid reversal if the economy proves to be seriously more robust - or stagflationary – than people are currently anticipating. The good news is that the collapse in the price of oil from a peak of US\$144 on 11th July to US\$49 on 21st November will both stimulate activity and act as a disinflationary shock in its own right, partly offsetting the immediate inflationary consequences of the weaker pound. On its own, the reduced price of oil made it likely that annual CPI inflation would ease from the 4.5% recorded in October to around 1¾% in the second half of next year, before averaging 2¼% in 2010 and just over 2% in 2011.

Outlook for CPI inflation

After allowing, in addition, for the temporary 2½% cut in the rate of VAT announced in the *Pre-Budget Report*, year-on-year CPI inflation is now likely to decline to reach a low-point of just over ½% in the third quarter of next year, before rising to just over 1% in the final quarter of 2009, according to the latest predictions of the Beacon Economic Forecasting (BEF) macroeconomic model. However, CPI inflation is expected to bounce back subsequently to average just over 3% in 2010, after the VAT cut is reversed, before easing to 1¾% in 2011. This is because the changes to VAT will have exaggerated the natural, and partly oil-price induced, cycle in CPI inflation. The likely consequence is that the Governor of the Bank of England will be writing a letter in the autumn of 2009 explaining an inflation undershoot, and another in 2010, explaining an overshoot.

Higher national insurance contributions will be extremely damaging

A more fundamental criticism of Mr Darling's measures is that they have ignored everything that economists know about the best and worst 'buys' when it comes to taxation. Because VAT is a flat rate, non-distortionary, consumption tax, it is one of the least economically damaging ways of raising revenue. National insurance contributions, in contrast, represent the most damaging tax where output and employment are concerned and one where raising the rate seems particularly likely to induce adverse 'Laffer-curve' effects (see: Chapter 4 of my 2006 IEA monograph *Living with Leviathan* (www.iea.org) for details). That is why Germany used a sharp rise in VAT to reduce employers' social overhead charges and achieved a marked reduction in unemployment as a result. The *Pre-Budget Report* measures are likely to prove permanently job destroying on this evidence. Fortunately, lower energy costs should stimulate both global and domestic activity, just as the sharp rise in the oil price undermined it. This effect is likely to offset some of the adverse consequences of the global credit crunch and the misguided *Pre-Budget Report* measures. There is possibly excessive gloom about international and British growth prospects over the next few years.

November Bank Rate cut passed through to money markets

As far as monetary policy specifically is concerned, the 1½% Bank Rate cut announced on 6th November appears to have 'worked' in the sense that the three-month LIBOR rate fell from 5.65% the day before to 3.94% on 21st November. This contrasts with the ½% cut announced on 8th October, after which LIBOR remained unchanged at 6.25%. The implication is that monetary policy has now regained some traction over

the money market yield curve. However, there is a strong likelihood that the huge government borrowing announced in the *Pre-Budget Report* will lead to higher bond yields and undo the gains from lower money-market rates. There is powerful evidence that budget deficits crowd out at least an equivalent volume of household consumption and private-sector investment. This means that the recession in the private sector of the economy will be exacerbated, not alleviated, by the Chancellor's fiscal fecklessness. As a consequence, official policies will have perversely amplified the natural cycles in output, as well as in inflation, in recent years. There now seems to be a good case for the MPC pausing for breath, until there has been an opportunity to see the effect of the fiscal and monetary measures taken already. This suggests that Bank Rate should be held in November. Beyond that, decisions will have to be determined by events, including the foreign-exchange and bond markets' considered reactions to the Chancellor's Hugo Chavez economics.

Comment by Peter Spencer

(University of York)

Vote: Cut base rate by 1%

Bias: To cut further if necessary

Aggressive rate cuts are the right policy

The balance of risk between inflation and recession shifted dramatically following the collapse of Lehman in September and in recognition of this the MPC has been cutting base rates aggressively. There is every reason to continue this aggressive programme in December. The market is looking for another ½% cut this month, but I can see no reason for holding back now. I would cut the base rate by another 1%, taking it down to the historic low of 2%.

UK economy is now in recession

It is clear that the economy moved into recession in the third quarter, probably before the Lehman collapse. Now, the intensification of the financial crisis will deal the economy a further blow. Despite the Chancellor's rescue package the inter-bank market remains paralyzed. There is already anecdotal evidence of credit starvation in the small company sector. The stock market, which held up remarkably well until Lehman failed, has also collapsed. M4 growth has been inflated by financial transactions but looks very weak if suitable allowances are made for this. Survey evidence suggests that output is sliding fast, particularly in the all-important service sector.

Risk of debt deflation and the November rate decision

Commodity prices have collapsed and inflation is set to fall dramatically now, as indicated by the fan chart in the Bank of England's November *Inflation Report*. This suggested that CPI inflation would fall below the 2% target and that negative inflation was a frighteningly real possibility. Rate cuts and falling house prices will mean the fall in RPI inflation is much steeper. There is a real risk of a debt deflation spiral developing here, which would be extremely difficult to escape given the high level of debt in the household sector. The MPC voted unanimously to cut interest rates by 150 basis points at the November meeting. A larger rate cut was considered, with the minutes stating that "the projections in the *Inflation Report* implied that a very significant reduction in Bank Rate – possibly

in excess of 200 basis points – might be required in order to meet the inflation target in the medium term”. Yet it decided to cut rates by less as it was concerned about the impact on sterling of surprising financial markets and wanted to assess the scale of fiscal loosening to be announced in the *Pre-Budget Report*.

Financial markets have priced in further rate cuts

The fall in sterling over the last month surely tells us that the markets have priced in the effect of future Bank Rate cuts. Moreover, the inflationary effect of any further falls will be outweighed by the effect of falling commodity prices, leaving the risks skewed to the downside. With the *Pre-Budget Report* now out of the way, there is no reason from holding back from another aggressive rate cut this month.

Market and mortgage rates still above Bank Rate

Market and administered rates remain well above policy rates. The three-month LIBOR at the time of writing was still 110 basis points above the base rate. There is a lot of pessimism about the ability of monetary policy to deal with this situation and the risk is that fiscal policy will remain top of the policy agenda. I do not share this pessimism. However we must give monetary policy its best shot lest we find ourselves embarking on yet more fiscal give-aways.

**Comment by Trevor Williams
(Lloyds TSB Corporate Markets)**

Vote: Cut by 1%

Bias: To ease

UK economy’s ‘turn for the worse’

The UK economy has taken a decided turn for the worse since September. This has been due to a combination of higher than expected inflation in the summer, which hit real incomes sharply, and the demise of Lehman Brothers, which hit financial market and business confidence hard, worsening economic growth in the third quarter. And this has continued in the fourth quarter of this year. As a result, manufacturing output remains in steep decline and the year-on-year volume growth in retail sales has slowed sharply, with the reduction in credit availability, tighter credit standards and wider spreads significantly exacerbating these negative forces. In addition, the global economic backdrop has worsened considerably, with any global leveraged position being badly hit as capital retreats to safe haven investments. Purchasing Managers’ Indices, business and consumer confidence, unemployment, and the housing market continue to worsen, implying that the downturn is still steep with worse to come.

Data justified changed policy stance

After the drop of 0.5% in economic output in the third quarter, a sharp cut in interest rates was justified, especially as the fall in commodity prices and the likelihood of them staying low for some months suggest scope to cut rates sharply. We should not be afraid of changing our monetary stance if the data justify it, and this is what the Bank of England did in the last *Inflation Report* and in the October and November MPC meetings. A further cut is now justified, to 2% in December. This would be in order to loosen policy in real terms to ‘get ahead of the curve’, and to signal that decisive action is being taken so helping to

maintain faith in the central banks' management of the crisis. As Roosevelt once said, "there is nothing to fear so much as fear itself".

**Fiscal policy
measures**

Fiscal policy measures should also be pointed towards offsetting the credit crisis and the risk of global recession. But this also means that as soon as the economy recovers, interest rates have to return to a neutral rate and fiscal policy must also return to sustainable basis so that international confidence in the pound is not undermined. The measures announced in the *Pre-Budget Report* added £20bn to the economy over the year ahead, equivalent to some 1.5% of national output and - by allowing the automatic stabilisers to work unimpeded - foresaw a big rise in borrowing, with the Budget deficit at 8% of GDP in fiscal 2009-10. There was little option but to do this. However, there must be a route mapped out after the economic recovery is underway to bring the public finances under firmer control.

**Monetary policy
should continue
to lean against
the slowdown**

In the meantime, this does not mean that monetary policy should not continue to lean against the slowdown and help to alleviate the credit crisis. If UK Bank rate is not cut in December, given the way that financial markets are positioned for one, there could be a severe market reaction, offsetting much of the fall that has taken place in the three-month interbank spread and wasting the cut of 1.5% in November. The October rise in money supply is reflecting strains in the money markets, but one would look for a fall in the months ahead. If not, then it implies that there is a long term inflation threat if monetary and fiscal policies do not return to neutrality as soon as the recession is either over - or about to recede - and the risk to credit markets is contained.

Note to Editors

What is the SMPC?

The Shadow Monetary Policy Committee (SMPC) is a group of independent economists drawn from academia, the City and elsewhere, which meets physically for two hours once a quarter at the Institute for Economic Affairs (IEA) in Westminster, to discuss the state of the international and British economies, monitor the Bank of England's interest rate decisions, and to make rate recommendations of its own. The inaugural meeting of the SMPC was held in July 1997, and the Committee has met regularly since then. The present note summarises the results of the latest monthly e-mail poll, conducted by the SMPC in conjunction with the Sunday Times newspaper.

SMPC membership

The Secretary of the SMPC is Kent Matthews of Cardiff Business School, Cardiff University, and its Chairman is David B Smith (University of Derby and Beacon Economic Forecasting). Other current members of the Committee include: Patrick Minford (Cardiff Business School, Cardiff University), Tim Congdon (Founder, Lombard Street Research), Gordon Pepper (Lombard Street Research and Cass Business School), Anne Sibert (Birkbeck College), Peter Warburton (Economic Perspectives Ltd), Roger Bootle (Deloitte and Capital Economics Ltd), John Greenwood (Invesco Asset Management), Peter Spencer (University of York), Andrew Lilico (Europe Economics), Ruth Lea (Arbuthnot Banking Group), and Trevor Williams (Lloyds TSB Corporate Markets). Philip Booth (Cass Business School and IEA) is technically a non-voting IEA observer but is awarded a vote on occasion to ensure that nine votes are cast.

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