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The Monetary Policy Committee: theory & performance.

This Paper looks at the history of the first four years of the Monetary Policy Committee. It examines the reasons given for its establishment, describes its actions and assesses its impact. It updates Research Paper 99/17 produced in February 1999.

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ECONOMIC POLICY AND STATISTICS

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Summary of main points

This Paper reviews the first four years experience of the Monetary Policy Committee (MPC). Established soon after the 1997 General Election, first informally and then later by the *Bank of England Act 1998*, the MPC is responsible for the determination of interest rates, and hence is highly influential in the setting of the overall monetary stance in the economy.

Its membership is drawn from Members of the Bank of England and from outside academics in roughly equal measure. Members' voting records are published as part of the minutes to the meetings. This allows an analysis of the different attitudes and inclinations of the individual members of the MPC. Attitudes have been characterised as being between the 'hawks'- members that are consistently more in favour of higher interest rates than others, and the 'doves' – those who favour a more relaxed policy. The analysis reveals that the Bank representatives have formed into a relatively homogenous group with Mervyn King (Deputy Governor) emerging as the chief 'hawk'. By contrast the outside representatives are far more likely to disagree with the majority view and one, Dr DeAnne Julius, who has recently left, emerging as the chief 'dove'.

Inferences about the rationale behind the MPC's decisions can be drawn from the published minutes. During the period a number of issues have been highlighted by the MPC as being the determinants of their decisions. These have included; concerns about the need to balance nominal demand and the supply potential of the economy (the output gap) and traditional concerns over the state of the labour market. As the May 2001 Inflation Report made clear, developments in the labour market are a key determinant of domestically generated inflation.

Whilst it maybe too soon to determine the long-term influence of the MPC, certain developments are already worth commenting upon. First, the Committee appears to have conducted its business in an open and harmonious manner, avoiding the disharmony evident in previous experiments of consensual economic policy-making and as such has gained political accord.

Following the MPC's establishment, there was an immediate reduction in long-term interest rates. Ten-year nominal forward rates-fell by about ½ a percentage point to reflect a corresponding fall in measured inflation risk, or, conversely an increase in the credibility of monetary policy. The UK's inflation performance over the period is broadly in line, or better, than the economic forecasts that were made before the MPC was created. Growth has remained relatively constant and employment has risen.

However, these conclusions have to be seen in the light of other economic factors, most of which have been conducive to low inflation. For example, UK growth rates have been at or below trend rates; slow growth in Europe, a high external value of the pound and until recently low world commodity prices.

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I Introduction

One of the first economic policy decisions taken by the incoming Labour Government in May 1997 was to announce the 'independence' of the Bank of England.[1] The idea of a new role for the Bank of England had appeared in the Party's 1997 general election manifesto:

> We will reform the Bank of England to ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political manipulation.

The Chancellor made his announcement even before the House had reconvened and extracts from his press statement of 6 May 1997 are shown below:

> The enemy of growth, and the investment necessary for it, is the instability of short periodic bursts of high growth followed by recession.
>
> So we must break from the short termism of the past - the economic instability that has characterised the British economy not just in recent years but for most of the century. That is why I want British economic success to be built on the solid rock of prudent and consistent economic management, not the shifting sands of boom and bust.
>
> Now is the time for long-termism. This is the time to set the British economy on a new long-term course that will deliver high levels of growth and employment through lasting stability.
>
> Price stability is, as I have said, an essential precondition for the Government's objectives of high and sustainable levels of growth and employment. The question is how to achieve the long-term stability that we seek?
>
> I have also made clear that reform is required to put monetary policy on a stable, long-term footing. In a speech in May 1995 and subsequently in our 1995 policy document, A New Economic Future for Britain, I set out my view of the proper roles of the Government and the Bank of England in economic policy.
>
> Government has a responsibility to the public in setting the objectives of economic policy and that means that the Government rather than the Bank of England must set the targets for monetary policy.
>
> However, as I have repeatedly made clear since 1995, we will only build a fully credible framework for monetary policy if the long-term needs of the economy, not short-term political considerations, guide monetary decision-making. We must

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[1] *The Bank of England Act 1998,* which gave the Bank that responsibility, came into force on 1 June 1998.

> remove the suspicion that short-term party political considerations are influencing the setting of interest rates.
>
> I am now satisfied that we can put in place, with immediate effect, reforms of the Bank of England to ensure that it can discharge responsibilities for setting interest rates in an effective, open and accountable way.
>
> This is the time to take the tough decisions we need for the long-term interests and prosperity of the country. I will not shrink from the tough decisions needed to deliver stability for long-term growth. I have therefore decided to give the Bank of England operational responsibility for setting interest rates, with immediate effect. The Government will continue to set the inflation target and the Bank will have responsibility for setting interest rates to meet the target. The Government's policy is set out in a letter I sent to the Governor yesterday, the text of which I am releasing now.
>
> But there is, as I have suggested today, a more long-term context. In the last century, Britain was industrially pre-eminent. The history of this century has been one of economic decline, not least because of short termism and the pursuit of stop-go economics. I am determined that we make the right preparations for long term national economic success, as we look to the century that lies ahead, so that we can move forward again economically. I am therefore setting in place a long-term policy for long-term prosperity. The ultimate judgement of the success of this measure will not come next week , or indeed in the next year but in the long- term. I am convinced that this radical reform, together with measures we will announce to equip our economy for the challenges ahead, creates the platform of stability upon which Britain can build

The outcome of this announcement, which was confirmed later in a statement to the House,[2] was the creation of a new organisation, one that would be responsible for the setting of monetary policy: the Monetary Policy Committee (MPC).

It may be too soon to test the contribution of the MPC to the long-term objectives outlined above with a degree of confidence. However, one can gain an impression of how the MPC works, analyse what influences it appears to recognise, the degree to which its membership hold convergent views and to what extent it has met its' objectives so far in the last four years.

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[2] HC Deb 20 May 1997 vol 294 cc 507 - 11

II The Monetary Policy Committee (MPC) in action

A. The MPC: organisation and remit

The MPC is accountable to the Government for its remit, to its Court of Directors for its procedures and to Parliament for all aspects of its operations through regular reports and evidence given to the Treasury Committee and Lords Select Committee on the Monetary Policy Committee.[3]

The relevant provisions of the *Bank of England Act 1998*[4] formally set out the role and constitution of the MPC. Section 11 states that:

> In relation to monetary policy, the objectives of the Bank of England shall be –
>
> (a) to maintain price stability, and
>
> (b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

The Government reviews and announces the inflation target at least once in every twelve-month period beginning on the anniversary of the day the *Bank of England Act 1998* came into force. The target the MPC has been given by the Chancellor since 1997 has been a 2.5% increase, over the previous twelve months, in the retail prices index excluding mortgage interest payments RPI(X). Mortgage interest payments are excluded since they 'confuse' the underlying trend of prices. A direct consequence of a rise in interest rates is to increase mortgage costs and these feed through into the rate of inflation. Thus the very thing that the decision of the MPC tries to prevent automatically happens if mortgage costs are included in the index. After being given the inflation target by the Chancellor the MPC has operational freedom how it meets that target.

Decisions on what actions need to be taken to achieve the target are taken by the MPC, on the basis of a majority vote. The membership of the Committee is set out under Section 13 of the Act. It includes the Governor and the two Deputy Governors of the Bank, two members appointed by the Governor after consultation with the Chancellor and four outside 'expert' members appointed by the Chancellor. The MPC has a two-day meeting on a monthly basis and all decisions on interest rates are announced immediately after the last day. The proceedings of the meetings, including votes, are now published within two weeks.[5]

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3 Treasury Committee, Ninth Report, 28 March 2001, HC 42 2000-2001, vii, para 3

4 *Bank of England Act 1998* Chapter 11

5 Minutes of each MPC meeting are available on the Bank of England website as at 19 June 2001: www.bankofengland.co.uk/mpc/minutes.htm

B. Membership of the MPC

Since it started fifteen individuals have served on the MPC. Brief biographical details of the current membership are shown below.

1. Bank of England Representatives

Sir Edward George

Sir Edward George is the Governor of the Bank of England and the Chairman of the MPC.

Mervyn King

Mervyn King is Deputy Governor of the Bank of England and Vice-chairman of the MPC. His responsibility within the Bank is for monetary stability and he is in charge of the monetary analysis and statistics division of the Bank. He is President of the Institute for Fiscal Studies and a former Board Member of the Securities Association.

David Clemanti

David Clemanti is Deputy Governor of the Bank of England. His main responsibility is for the stability of the financial system. Mr Clemanti joined the MPC in September 1997 following the departure of a previous Deputy Governor, Howard Davies, who became the Chairman of the Financial Services Authority. He is a director of the Financial Services Authority, a director of the Accountancy Foundation and a member of the Appointments Committee, Press Complaints Commission.

Professor Charles Bean

Charles Bean is Professor of Economics and Head of Department at the London School of Economics. He succeeded John Vickers (who became Director General of the Office of Fair Trading) during 2000 as Chief Economist and Executive Director at the Bank and is responsible for monetary analysis and statistics. He is a member and former chairman of the Treasury's Academic Panel, a consultant to the Treasury's Macroeconomic Policy and Prospects division, a former adviser to the Treasury Committee of the House of Commons and also to the Economic and Monetary Affairs Committee of the European Parliament.

Ian Plenderleith

Ian Plenderleith is an Executive Director at the Bank and is responsible for the stability of the Bank's financial market operations. He is also a member of the Board of the London Stock Exchange and is a Fellow of the Association of Corporate Treasurers and a member of the Securities Institute.

2. Outside Academics

Dr Sushil Wadhwani

Dr Sushil Wadhwani is currently a member of the Clare group of economists and Visiting Professor at the City University Business School and the London School of Economics (LSE) and has previously been Director of Research at Tudor Proprietary Trading LLC and Director of Equity Strategy at Goldman Sachs International.

Professor Stephen Nickell

Professor Stephen Nickell is School Professor of Economics at the LSE (part-time), President of the European Association of Labour Economists and President-Elect of the Royal Economic Society. He is a Fellow of the British Academy and of the Econometric Society as well as being a member of the International Board of Advisers of the Tinbergen Institute (Amsterdam) and member of the Council of the European Economic Association. He has acted as academic consultant for various government bodies including HM Treasury, the Manpower Services Commission and the DHSS.

Christopher Allsopp

Mr Allsopp is a Reader in Economic Policy and Fellow in Economics at New College, Oxford. A specialist in international macroeconomics, Mr Allsopp's previous experience includes work at the OECD in Paris and as an adviser at the Bank as well as consulting appointments with overseas Governments and many other UK and international organisations.

Kate Barker

Kate Barker joined the MPC on 1 June 2001 taking the place of Dr DeAnne Julius who did not seek reappointment. Ms Barker is Chief Economist at the Confederation of British Industry and is a Member of the Institute for Public Policy Research's Commission on Public Private Partnerships. She has previously been Chief Economist at Ford Europe and a Member of HM Treasury Panel of Independent Forecasters.

C. Decisions taken by the MPC

The policy instrument controlled by the MPC is a key money market interest rate now referred to as the repo rate. Up to June 2001, the MPC has taken forty-nine interest rate decisions and of these nineteen changed the rate. On nine occasions the rate was raised and reduced ten times. On sixteen occasions the change was a 0.25% change and three times it has been a 0.5% change. The history of rate changes is shown in more detail in the table on the next page.

MPC Decisions			**Base/Repo Rate**
Date of announcement		Decision	Revised rate
1997	Jun 6	$^1/_4$ % increase	6.50
	Jul 10	$^1/_4$ % increase	6.75
	Aug 7	$^1/_4$ % increase	7.00
	Nov 6	$^1/_4$ % increase	7.25
1998	Jun 4	$^1/_4$ % increase	7.50
	Oct 8	$^1/_4$ % decrease	7.25
	Nov 5	$^1/_2$ % decrease	6.75
	Dec 10	$^1/_2$ % decrease	6.25
1999	Jan 7	$^1/_4$ % decrease	6.00
	Feb 4	$^1/_2$ % decrease	5.50
	Apr 8	$^1/_4$ % decrease	5.25
	June 10	$^1/_4$ % decrease	5.00
	Sept 8	$^1/_4$ % increase	5.25
	Nov 4	$^1/_4$ % increase	5.50
2000	Jan 13	$^1/_4$ % increase	5.75
	Feb 10	$^1/_4$ % increase	6.00
2001	Feb 8	$^1/_4$ % decrease	5.75
	Apr 5	$^1/_4$ % decrease	5.50
	May 10	$^1/_4$ % decrease	5.25

Source: Bank Of England

D. 'Hawks' & 'Doves'

As the voting record of the membership is published as part of the minutes to the meetings there has been some interest in the voting record of the individual members of the MPC. From this we can see if some members are consistently more in favour of higher interest rates than others who favour a more relaxed policy, so called 'hawks' and 'doves' respectively

The full voting record is displayed in a stylised way in the Membership Voting Record table on the following pages (pages 14&15). Each recorded vote is given a 'score'. A vote for the majority view is given a score of one. A vote for a rate of interest higher than the majority view has a score of two and a vote for a rate of interest lower than the majority view has a score of zero. Hence a 'hawk' will have a number of 'twos', whereas a 'dove' will have some zeroes.

The table reveals a few interesting features. As might be expected the Bank representatives formed into a relatively homogenous group[6] although, on nine occasions Mervyn King has voted for higher interest rates than the other Bank representatives. By contrast the outside representatives are far more likely to disagree with the majority view.[7] On three occasions, May and August 1998 and January 1999, votes have been recorded for all three options, i.e. raising interest rates more and less than the majority view. This may confirm the popular perception of the propensity of economists to disagree amongst themselves.

Constructed in this way the full voting table can be used to determine a 'hawk/dove' index. In the table below the Committee Members' average score is determined.

MPC

'Hawk' Index June 1997- June 2001

Member	Number of votes taken	Average score'
Bank Representatives		
Mervyn King	49	1.2
John Vickers	28	1.2
David Clemanti	47	1.0
Sir Edward George	49	1.0
Howard Davies	1	1.0
Ian Plenderleith	49	1.0
Charles Bean	9	0.9
Outside Representatives		
Professor Stephen Nickell	13	1.2
Sir Alan Budd	18	1.2
Professor Charles Goodhart	36	1.1
Professor Willem Buiter	36	1.0
Kate Barker	1	1.0
Christopher Allsopp	13	0.9
Dr Sushil Wadhwani	25	0.7
Dr Deanne Julius	45	0.7

Source: MPC *Monthly Minutes*, various months

The results are not very surprising with the Bank representative's scores relatively close to one. The outside representatives vary from the most hawkish of all members – Professor Stephen Nickell to the least – Dr Deanne Julius. Within these overall averages one might note that Professor Buiter has the fewest scores of one. Of the thirty-six decisions he took part in, on seventeen (43%) occasions he voted for different rates of interest than the majority. Nine times (25%) for rates of interest higher and eight times (22%) for interest rates below those proposed by the majority.

6 91% of Bank representative's votes have been in accordance with the majority view, while 2% and 7% have been votes for a rate of interest lower and higher, respectively, than the majority view.

7 74% of outside representative's votes have been in accordance with the majority view, while 16% and 10% have been votes for a rate of interest lower and higher, respectively, than the majority view.

Monetary Policy Committee

Membership Voting Record, Bank Representatives, June 1997- June 2001

Date of announcement		Decision	Sir Edward George	Mervyn King	David Clementi	Ian Plenderleith	John Vickers	Howard Davies	Charles Bean
1997	Jun 6	1/4 % increase	1	1	1	1	na	na	na
	Jul 10	1/4 % increase	1	1	na	1	na	1	na
	Aug 7	1/4 % increase	1	1	na	1	na	na	na
	Sept 11	no change	1	1	1	1	na	na	na
	Oct 9	no change	1	1	1	1	na	na	na
	Nov 6	1/4 % increase	1	1	1	1	na	na	na
	Dec 4	no change	1	1	1	1	na	na	na
1998	Jan 8	no change	1	1	1	1	na	na	na
	Feb 5	no change	1	2	1	1	na	na	na
	Mar 5	no change	1	2	1	1	na	na	na
	Apr 9	no change	1	2	1	1	na	na	na
	May 7	no change	1	1	1	1	na	na	na
	Jun 4	1/4 % increase	1	1	1	1	1	na	na
	Jul 9	no change	1	1	1	1	1	na	na
	Aug 6	no change	1	1	1	1	1	na	na
	Sept 10	no change	1	1	1	1	1	na	na
	Oct 8	1/4 % decrease	1	1	1	1	1	na	na
	Nov 5	1/2 % decrease	1	1	1	1	1	na	na
	Dec 10	1/2 % decrease	1	1	1	1	1	na	na
1999	Jan 7	1/4 % decrease	1	1	1	2	1	na	na
	Feb 4	1/2 % decrease	1	1	1	1	1	na	na
	Mar 3	no change	1	1	1	1	1	na	na
	Apr 8	1/4 % decrease	1	1	1	1	1	na	na
	May 6	no change	1	1	0	0	1	na	na
	June 10	1/4 % decrease	1	2	1	1	1	na	na
	July 8	no change	1	1	1	1	1	na	na
	Aug 5	no change	1	1	1	1	1	na	na
	Sept 8	1/4 % increase	1	1	1	1	1	na	na
	Oct 7	no change	1	1	1	1	1	na	na
	Nov 4	1/4 % increase	1	1	1	1	1	na	na
	Dec 9	no change	1	2	1	1	2	na	na
2000	Jan 13	1/4 % increase	1	1	1	1	1	na	na
	Feb 10	1/4 % increase	1	1	1	1	1	na	na
	Mar 9	no change	1	1	1	1	1	na	na
	Apr 6	no change	1	2	1	1	2	na	na
	May 4	no change	1	1	1	1	1	na	na
	June 7	no change	1	2	1	1	2	na	na
	July 6	no change	1	1	1	1	1	na	na
	Aug 3	no change	1	2	2	1	2	na	na
	Sept 7	no change	1	2	2	1	2	na	na
	Oct 5	no change	1	1	1	1	na	na	1
	Nov 9	no change	1	1	1	1	na	na	1
	Dec 7	no change	1	1	1	1	na	na	1
2001	Jan 11	no change	1	1	1	1	na	na	0
	Feb 8	1/4 % decrease	1	1	1	1	na	na	1
	Mar 8	no change	1	1	1	1	na	na	1
	Apr 4	1/4 % decrease	1	1	1	0	na	na	1
	May 10	1/4 % decrease	1	1	1	1	na	na	1
	June 6	no change	1	1	1	1	na	na	1

Notes: 1 - vote was in accordance with majority view
2 - vote was for a rate of interest higher than the majority view
0 - vote was for a rate of interest lower than the majority view
* - attended as Treasury observer - no vote   na - did not attend, not appointed or had left at that date

Source: MPC *Monthly minutes*, various months

Monetary Policy Committee

Membership Voting Record, Outside Representatives, June 1997- June 2001

Date of announcement		Decision	Sir Alan Budd	Professor Willem Buiter	Professor Charles Goodhart	Dr Deanne Julius	Dr Sushil Wadhwani	Professor Stephen Nickell	Christopher Allsopp	Kate Barker
1997	Jun 6	$^1/_4$ % increase	*	1	1	na	na	na	na	na
	Jul 10	$^1/_4$ % increase	*	1	1	na	na	na	na	na
	Aug 7	$^1/_4$ % increase	*	1	1	na	na	na	na	na
	Sept 11	no change	*	1	1	1	na	na	na	na
	Oct 9	no change	*	1	1	1	na	na	na	na
	Nov 6	$^1/_4$ % increase	na	1	1	1	na	na	na	na
	Dec 4	no change	1	1	1	1	na	na	na	na
1998	Jan 8	no change	2	2	2	1	na	na	na	na
	Feb 5	no change	2	2	2	1	na	na	na	na
	Mar 5	no change	2	2	2	1	na	na	na	na
	Apr 9	no change	2	2	1	1	na	na	na	na
	May 7	no change	1	2	1	0	na	na	na	na
	Jun 4	$^1/_4$ % increase	1	1	1	0	na	na	na	na
	Jul 9	no change	1	1	1	1	na	na	na	na
	Aug 6	no change	1	2	1	0	na	na	na	na
	Sept 10	no change	1	0	1	0	na	na	na	na
	Oct 8	$^1/_4$ % decrease	1	0	1	0	na	na	na	na
	Nov 5	$^1/_2$ % decrease	1	0	1	1	na	na	na	na
	Dec 10	$^1/_2$ % decrease	1	0	1	1	na	na	na	na
1999	Jan 7	$^1/_4$ % decrease	1	1	1	0	na	na	na	na
	Feb 4	$^1/_2$ % decrease	1	0	1	1	na	na	na	na
	Mar 3	no change	1	0	1	1	na	na	na	na
	Apr 8	$^1/_4$ % decrease	1	0	1	1	na	na	na	na
	May 6	no change	1	0	1	0	na	na	na	na
	June 10	$^1/_4$ % decrease	na	1	1	1	1	na	na	na
	July 8	no change	na	1	1	1	1	na	na	na
	Aug 5	no change	na	1	1	1	1	na	na	na
	Sept 8	$^1/_4$ % increase	na	1	1	0	0	na	na	na
	Oct 7	no change	na	1	1	1	1	na	na	na
	Nov 4	$^1/_4$ % increase	na	1	1	0	1	na	na	na
	Dec 9	no change	na	2	1	1	1	na	na	na
2000	Jan 13	$^1/_4$ % increase	na	2	1	1	1	na	na	na
	Feb 10	$^1/_4$ % increase	na	1	1	0	1	na	na	na
	Mar 9	no change	na	1	1	1	1	na	na	na
	Apr 6	no change	na	2	1	1	1	na	na	na
	May 4	no change	na	1	1	1	1	na	na	na
	June 7	no change	na	na	na	1	1	2	1	na
	July 6	no change	na	na	na	1	1	1	1	na
	Aug 3	no change	na	na	na	1	1	2	1	na
	Sept 7	no change	na	na	na	1	1	2	1	na
	Oct 5	no change	na	na	na	1	1	1	1	na
	Nov 9	no change	na	na	na	1	1	1	1	na
	Dec 7	no change	na	na	na	0	0	1	1	na
2001	Jan 11	no change	na	na	na	0	0	1	0	na
	Feb 8	$^1/_4$ % decrease	na	na	na	1	1	1	1	na
	Mar 8	no change	na	na	na	0	0	1	1	na
	Apr 4	$^1/_4$ % decrease	na	na	na	0	0	1	1	na
	May 10	$^1/_4$ % decrease	na	na	na	1	0	1	1	na
	June 6	no change	na	na	na	na	0	1	1	1

Notes: 1 - vote was in accordance with majority view
2 - vote was for a rate of interest higher than the majority view
0 - vote was for a rate of interest lower than the majority view
* - attended as Treasury observer - no vote
na - did not attend, not appointed or had left at that date

Source: MPC *Monthly minutes*, various months

III What determines the MPC's decisions?

A. Introduction

This section looks at thinking behind the decisions taken by the MPC. It will be recalled that the policy outlined in the Labour Party manifesto was:

> We will reform the Bank of England to ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political influence.

Part of the commitment to openness has been the timely publication of the minutes, now published within two weeks of the MPC meetings. From these it is possible to gain an impression of the importance attached to various economic factors that determined the Committee's final decision.

B. The decisions

Extracts from the Bank's press releases issued when interest rates were changed are shown below together with various contextual comments. Comments shown in bold are the author's emphasis.

Date: June 1997.
Decision: Interest rates raised by 0.25% to 6.50%.

> The Bank's Monetary Policy Committee has reviewed the latest monetary and economic data. It concluded that the latest evidence is consistent with the outlook described in the Bank's Inflation Report published on 13 May. Notwithstanding the strength of the exchange rate, which is expected to restrain retail price inflation temporarily in the near term, the Report concluded that "the central projection for inflation, and the risks surrounding it, suggests that, on the present evidence, there is still likely to be a need for some further moderate tightening of policy in the months ahead."

This tells us little other than the fact that, on the Bank's view; inflationary pressures were building in the economy at the time of the 1997 General Election.

Date: 10 July 1997
Decision: Interest rates raised by 0.25% to 6.75%

> The combination of rapid expansion of domestic demand led by consumption and the further appreciation of sterling has sharpened the dilemma for monetary policy. **The Monetary Policy Committee's task is to aim to balance nominal demand and the supply potential of the economy, in order to meet the inflation target and create the conditions for sustained growth of output and employment.** Continued growth of output at well above trend rates would be unsustainable.

> The Committee reviewed the latest monetary and economic data against the background of the Bank's Inflation Report published on 13 May and the 0.25% rise in official interest rates announced on 6 June. It concluded that the latest month's evidence - notably the upward revision of estimated output growth in the fourth quarter of 1996 and recent developments in monetary growth and retail sales - indicated that a further tightening of monetary policy was necessary, notwithstanding the further appreciation of the exchange rate and the contractionary effects of the recent Budget.

If there is one persuasive factor in this analysis it is the position of the UK economy above its trend growth pattern. The Committee clearly held a view that whatever other influences were coming into play the most important factor was the growth rate of the economy.

Date: 7 August 1997
Decision: Interest rates raised by 0.25% to 7.0%

> The Committee recognised that the appreciation of the exchange rate over the past year is putting severe pressure on businesses exposed to international competition.
>
> Nevertheless, in the light of the prospect for domestic demand and on the basis of all the evidence currently available, the Committee judges that today's rise is necessary to put the economy on track for achieving the inflation target of 2½% looking two years ahead. Although the present strength of sterling reflects in large part factors outside the influence of UK monetary policy, upward pressures on the exchange rate should be reduced by the perception that interest rates have reached a level consistent with the inflation target.

Perhaps the most important feature of this notice is the subsidiary influence (despite the laboured – and subsequently inaccurate hint to the markets at the end of the notice) of the exchange rate at a time when sterling was at its highest level for almost a decade.

Date: 6 November 1997
Decision: Interest rates raised by 0.25% to 7.25%

> Inflation has not moderated as much as expected in the light of sterling's appreciation since the autumn of 1996. Domestic demand has remained robust, and the expected impact on external trade, lowering export volumes and raising import volumes, has yet to materialise, so that **GDP has continued to grow at an unsustainable rate. The labour market has tightened further, with skill shortages increasingly reported.**
>
> Looking ahead, the economy is expected to slow down next year as both domestic demand and net external trade moderate, under the combined impact of past tightening in monetary and fiscal policy, the strength of sterling, and a smaller impact of windfalls on consumption. This will help to reduce inflationary

> pressures. But, in the Committee's judgement, the balance of risks implies that a modest further increase in interest rates is necessary to meet the inflation target of 2½% in the medium term.

This was the first of several press releases to mention labour market conditions as indicators of inflationary pressure. Again the main issue of concern appears to have been the 'unsustainable' rate of growth in the economy. 'Windfalls' refers to the sums accruing to individuals when, typically, a building society converted into a bank and compensated its previous members with generous payments.

Date: 4 June 1998
Decision: Interest rates raised by 0.25% to 7.25%

> In the May Inflation Report, the Committee said that: "In the central projection, inflation is expected to remain close to its target throughout the forecast period after the temporary increase in the second quarter of this year. But there are major uncertainties which mean that the outlook for monetary policy remains finely balanced."
>
> The central issue for monetary policy remains whether aggregate demand will slow sufficiently quickly to bring down domestically generated inflation before the restraining price effects of the earlier increase in the exchange rate and falls in commodity prices wear off. As the May Inflation Report made clear, **developments in the labour market are a key determinant of domestically generated inflation**. Evidence has emerged over the past month that the cumulative tightening of the labour market has resulted in a rate of private sector earnings growth that jeopardises achievement of the inflation target over the medium run. Moreover the sterling exchange rate has remained about 3% lower than in the central projection of the May Inflation Report. While there are increased uncertainties in the external environment, inflationary pressures appear greater than in the May projection, and the need for a slowdown in domestic demand growth has become more pressing.

This month too saw explicit reference to the labour market as a "key determinant" of the Committee's decision. However, it emerged later that the figures for average earnings produced by the Office of National Statistics were unreliable and publication of the series was suspended, subject to review, soon afterwards.

Date: 8 October 1998
Decision: Interest rates reduced by 0.25% to 7.25%

> The international economic and financial environment has deteriorated since the Committee met in September. In the domestic economy, surveys and reports from the Bank's Regional Agents have indicated a decline in business and consumer confidence. The outlook for demand and output has therefore weakened. Despite continuing tightness in the labour market and the fall in the exchange rate, the Committee judges that the risks of inflation falling below the target of 2.5% have increased and that a reduction in interest rates of 0.25% is now appropriate.

This was the first release to make specific mention of regional influences. The Bank's Regional agents are a historical throwback to the days when the Bank had a regional branch network to deal with the failures of local note-issuing banks. Over time, and after several initiatives and reorganisations, the agents developed an industrial liaison role. Their work was described in an article from the Bank of England Quarterly Bulletin as being:

> To maintain contact with industry and commerce and to report on the economy as seen by those based in the area. The Agencies play an important part in enabling the Bank to collect 'proper regional and sectoral information for the purpose of monetary policy formation' (as required by the Chancellor's letter to the Governor of the 6 May 1997).[8]

For some considerable time there had been calls from industry for help with the problems that they were experiencing following the high value of sterling. One channel through which these calls could flow would be the contacts that industry had with the regional agents.

Date: 5 November 1998
Decision: Interest rates reduced by 0.5% to 6.75%

> Since the August Inflation Report was published, news about the international environment and the prospects for domestic activity have led the Committee to moderate its forecast for growth next year and to revise downwards its projection for inflation over the next two years. As a result, the Committee concluded that a reduction in interest rates of 0.5% was appropriate in order to maintain a path for inflation consistent with the target.

References to the international environment appear to refer to the collapse of the Russian economy, following the floating of the rouble in the August, along with a deepening of the recession in Japan and substantial falls in equity markets around the world: the FTSE 100 fell by 24% between March and September 1998.[9]

Date: 10 December 1998
Decision: Interest rates reduced by 0.5% to 6.25%

> Since the November Inflation Report, the prospect for global activity appears to have weakened and commodity prices have fallen further. In the UK, GDP growth in the third quarter was revised down, and surveys of activity have continued to indicate deterioration across the economy, although the labour market is still tight and monetary and financial indicators remain relatively

[8] Bank of England, *Quarterly Bulletin*, November 1997, p 424
[9] National Statistics, *Financial Statistics*, October 1999, table 7.1G

strong. The Monetary Policy Committee judged that the downside risks to both activity and inflation have increased, and therefore reduced interest rates by 0.50% to keep prospective inflation on track to meet the 2.5% target.

Date: 7 January 1999
Decision: Interest rates reduced by 0.25% to 6.00%

Since the Committee's December meeting, **domestic data and survey evidence have, on balance, shown a continuing slowdown in the UK economy**. The labour market remains tight but it seems to have reached a turning point. Evidence from wage settlements and the Bank's regional Agents suggest an easing of upward pressures on growth in pay. The risks from the international environment remain clearly on the downside. In these circumstances the Committee judged that a further reduction in interest rates of 0.25% to 6.0% was appropriate in order to maintain a path for inflation consistent with the target.

Date: 4 February 1999
Decision: Interest rates reduced by 0.5% to 5.50%

Taking account, in particular, of the prospects for international activity and prices, domestic costs and consumer demand, the Committee's latest inflation projections implied that a further reduction in interest rates was necessary to keep inflation on a path consistent with the target of 2 ½%.

The Bank of reduced interest rates for the fifth successive month in an attempt to stop economic slowdown turning into a full-scale recession.

Date: 8 April 1999
Decision: Interest rates reduced by 0.25% to 5.25%

No Statement released

The Bank offered no explanation for its decision, unlike the previous reductions that had been accompanied by a short statement.

At the time, some City economists suggested this might meant a split decision among the MPC members[10] but as can be seen from the table on pages 15 & 16, only Professor Buiter's decision was against that of the majority. The decision of the MPC may have been influenced by the weakness of inflationary wage pressure in the labour market. After falling almost continuously since the end of 1992, the rate of unemployment slowed sharply, helping to keep wage rises under control. The decision may also have been affected by the resilience of sterling - which remained at around the level it was at with relation to the German mark when this round of interest rate cuts began in October 1998.

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[10] *MPC brevity taken as hint of a split* The Guardian, 9 April 1999

Date: 10 June 1999
Decision: Interest rates reduced by 0.25% to 5.00%

> The Committee considered recent economic developments against the background of the May Inflation Report. Taking into account all the evidence on the inflation outlook, the Committee judged that it is now more likely that inflation will undershoot the 2 ½% target.

The 0.25% cut in interest rates to 5.00% reduced them to their lowest level since October 1977.[11]

Date: 8 September 1999
Decision: Interest rates raised by 0.25% to 5.25%

> The Committee reviewed developments since its last meeting, including **world demand, the strength of consumption and the housing market, and continuing tight conditions in the labour market**. Although inflation is expected to remain below the target of 2½% in the short term, the Committee concluded that a rise in interest rates was necessary to keep inflation on track further ahead, and that an early move could lower the level at which interest rates might otherwise need to be set.

In the second quarter of 1999, household spending grew by 1.4% and was up by 4% on a year earlier. Investment was also up strongly, by 6.7% as an annual rate. Growth forecasts for 1999, clustered around 0.75% in the spring, were revised to 1.5%, the top end of the range laid out in the March 1999 budget. Consumer demand was expanding more quickly than the chancellor expected, while the current account was also looking worse than predicted.

Date: 4 November 1999
Decision: Interest rates raised by 0.25% to 5.50%

> No Statement released

Date: 13 January 2000
Decision: Interest rates raised by 0.25% to 5.75%

> The Committee reviewed monetary and economic developments since its previous meeting. **The outlook for world economic activity has strengthened. Prospective growth in domestic demand remains strong: increases in wealth, labour income and household borrowing all suggest**

[11] Minimum Lending Rate reduced by 0.5% at 17 October 1977.

> **that consumer spending will continue to grow robustly**. Inflation is currently below the 2½% target and is expected to remain so for a while, but it is likely to rise above target further ahead, reflecting developing pressures in the labour market and on productive capacity. Accordingly the Committee concluded that an increase in interest rates of 0.25% to 5.75% was needed to meet the inflation target in the medium term.

House prices were still rising after the two previous rises in interest rates. At the time the Halifax reported that house prices rose by 3.4% in the final quarter of 1999 and by 11.5% for the year as a whole.[12]

Date: 10 February 2000
Decision: Interest rates raised by 0.25% to 6.00%

No Statement released

Date: 8 February 2001
Decision: Interest rates reduced by 0.25% to 5.75%

No Statement released

The MPC's decision to reduce the interest rate by 0.25% was the first change in twelve-months and followed reduced expectations of GDP growth and falls in equity prices both in the UK and internationally.

Preliminary estimates suggested that the quarter on quarter UK GDP growth rate had eased to 0.3% in 2000 Q4 from 0.7% in 2000 Q3, although the average of new forecasts for UK GDP growth in 2001 remained constant at 2.6% between December 2000 and January 2001.[13] International Consensus forecasts of GDP growth in the US for 2001 fell from 3.0% to 2.6%, from 2% to 1.8% for Japan and from 3% to 2.9% for the Euro zone.[14]

A reduction in the share price of high technology companies lead to a fall in the FTSE from September 2000 to January 2001 of over 11%.[15] Share prices had also fallen in other major markets over the same period; the US S&P 500, Japan Nikkei 225 and Germany DAX indices fell by approximately 13%, 19% and 13% respectively.[16]

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[12] *No time for half measures* The Guardian, 14 January 2000.
[13] HM Treasury, *Forecasts for the UK economy: A comparison of independent forecasts*, various months
[14] Bank of England, *Minutes of MPC Meeting 7 and 8 February 2001*, 21 February 2001
[15] *Financial Statistics*, National Statistics, May 2001, table 7.1G
[16] Financial Times Market Watch web site, www.ftmarketwatch.com as at 10 June 2001

Date: 5 April 2001
Decision: Interest rates reduced by 0.25% to 5.5%

> **While growth in final domestic demand has remained firm, there are downside risks to UK activity from the slowdown in the global economy, the recent fall in equity markets and, in the short run, from foot and mouth disease.** These developments could already have affected demand and output growth and may continue to do so, in particular through their impact on business and consumer confidence. Inflation is currently somewhat below target, and is expected to remain so for a while. Price and cost pressures continue to be subdued. There is little sign of any easing yet in the labour market but, despite its tightness, settlements and earnings growth have so far remained moderate. In addition, the strength of sterling continues to exert a dampening effect on inflation.

The move triggered an immediate response from banks and building societies reducing mortgage rates to their lowest level for 36 years.

Date: 10 May 2001
Decision: Interest rates reduced by 0.25% to 5.25%

> The world economic prospect has on balance continued to weaken. The extent and duration of the slowdown remain uncertain. In the UK, final domestic demand has so far remained firm, but **output growth in Q1 was slower than expected and there has been some weakening in business confidence**. The labour market remains tight. While the latest data showed faster earnings growth, this was largely the result of temporary factors, and settlements remain broadly stable. More generally, price and cost pressures are subdued. As the Committee noted a month ago, inflation is currently somewhat below target, and is expected to remain so for a while.

Preliminary estimates of UK GDP in 2001 Q1 suggested the quarter on quarter growth of GDP had eased for the third quarter running. The quarter on quarter UK GDP growth rate had eased to 0.3% in 2001 Q1 from a revised 0.4% in 2000 Q4,[17] although the average of new forecasts for UK GDP growth in 2001 remained constant at 2.6%.[18]

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17 National Statistics Press Release *Gross domestic product* 27 April 2001
18 HM Treasury, *Forecasts for the UK economy: A comparison of independent forecasts*, various months

IV Has the MPC worked?

A. Introduction

It may still be too soon to be able to judge, with a degree of confidence, whether or not the MPC has fulfilled the broad aims set out for it by the Chancellor:

> Now is the time for long-termism. This is the time to set the British economy on a new long-term course that will deliver high levels of growth and employment through lasting stability.
>
> Price stability is, as I have said, an essential precondition for the Government's objectives of high and sustainable levels of growth and employment. The question is how to achieve the long-term stability that we seek?[19]

It may take longer than the four years of experience of the MPC we have to date, to see whether we can view it's operations as a success or failure as in the international arena the past four years have been a period of relative stability. However, it is still possible to look for what has been achieved by the MPC so far.

B. Achievements

1. Conduct of the MPC

Perhaps the first achievement is that the Committee appears to have conducted its business in a harmonious manner. Differences of opinion and emphasis are acknowledged within the minutes of the discussion, however, there has been no obvious sign of public, off-the-record, briefings by disenchanted members or sudden acrimonious resignations. One can contrast this with what happened during the previous attempt at consensual advice giving by a group of economists and government, namely the Treasury's group of 'wise men' who gave advice to the Chancellor on the management of the economy. This group was set up in 1992 in the aftermath of the UK's exit from the ERM. It developed into a body with no coherent view and ended after some highly public rows between some of its members.

No less important in terms of the Committee's prestige and authority was the move taken in October 1997 to reduce the period between the date of the meeting and the publication of the minutes to just two weeks instead of the permitted six weeks delay. This move

[19] Chancellor's statement, HM Treasury press release, 6 May 1997

improved the transparency of the Committee's decisions and makes the job of the market in interpreting it and predicting future moves much simpler.[20]

2. Political consensus

Prior to the 1997 General Election the Conservative Party's manifesto promised to keep an inflation target of 2.5% but contained no references to the independence of the Bank suggesting that the Chancellor would continue to set the interest rate. While the Labour Party's manifesto did not use the word 'independence' it did contain a pledge to:

> …reform the Bank of England to ensure that decision making on monetary policy is more effective, open, accountable and free from short-term political manipulation.

and the Liberal Democrats manifesto pledged to:

> …turn the Bank of England into a UK Reserve Bank free from political interference.

Since independence the apparent success of the MPC in meeting its' main objective has lead to political acceptance of Bank independence amongst the main parties. Almost immediately after his appointment as Shadow Chancellor, in February 2000, Michael Portillo reversed the Conservative Party's opposition to an independent Bank: [21]

> The next Conservative Government will respect the independence of the Bank of England and will legislate to enhance that independence and increase accountability to Parliament.

In setting out the Conservatives' macro-economic policy stance in December 2000 Michael Portillo expanded on their proposals for the terms of the Banks' independence:[22]

> I thoroughly welcome the independence of the monetary policy committee of the Bank of England. But I believe we should enhance that independence as well as better define its accountability to parliament. Again we must be aware that the new arrangements have not been tested in difficult conditions. Now is the time to think about how we can improve on what the government put in place in a hurry and without consultation. The Conservative Party appointed a distinguished commission on the Bank and we will be guided by the findings, which were published earlier this year.

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[20] For an assessment of the impact of interest rate announcements on UK financial markets see *Assessing the impact of Macroeconomic news announcements on securities prices under different monetary policy regimes* Bank of England Working Paper Series, No 125, February 2001

[21] HC Deb 3 February 2000 vol 343 cc1189-91

[22] Conservative Party News Release, *Five Disciplines for Macro-economic Policy*, Conservative Party web site as at 7 June 2001: www.conservatives.com/show_news_item.cfm?&obj_id=481&SPEECHES=1

> It must be made clear that the responsibility for setting the inflation target rests with the Chancellor of the Exchequer, who is responsible to parliament. The MPC is required to make the interest rate decisions necessary to achieve the Chancellor's target. In the event that the target is missed – because of some major systemic shock – in our view it is the Chancellor who should prescribe the path of intermediate inflation targets that must lead back towards the long-term inflation target. There is little guarantee under present arrangements that the members of the MPC will necessarily be independent or the right people, though I have no complaints about those who have actually taken up positions. For there to be greater confidence in the process, the members should be appointed following a fully transparent procedure… They should report to a special committee of parliament on the manner in which they have carried out their duties.
>
> The MPC should be encouraged, if it sees fit, to comment on whether it would have made different interest rate decisions had the fiscal stance been different; in other words the members should be entirely free to comment on any inconsistency between monetary and fiscal policy. I believe the Chancellor's inflation target of two-and-a-half per cent to be appropriate at present. There is a range around it, and if the MPC goes outside the range it is required to write to the Chancellor to explain how that situation has arisen and how it will be corrected. We think that appropriate too. But if the MPC continues to undershoot the inflation target, we will have to consider both whether to lower the target and whether to narrow the range.

Setting out their stance on the Banks' independence in October 2000, the Liberal Democrat Shadow Chancellor Matthew Taylor suggested that the Liberal Democrats would "increase the independence and effectiveness of the Bank of England" by introducing proposals which aimed to:[23]

- Increase the independence of Bank of England Monetary Policy Committee members
- Make the process of appointing Monetary Policy Committee members more transparent so that their skills are more clearly defined
- Make fiscal policy more responsible to discourage irresponsible pre-election cuts in taxes or boosts to spending

Commenting further on the proposals Matthew Taylor said:

> The Chancellor refuses to tell us how he appoints Monetary Policy Committee members, yet their decisions affect every family and business in Britain. There

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[23] Liberal Democrat Press Notice, *Liberal Democrats Propose a more Independent and Effective Bank of England*, 16 October 2000 Liberal Democrat website as at 7 June 2001: www.libdems.org.uk/index.cfm?page=homepage&section=home&article=606

> should be an honest and open debate about future appointments. There is also a temptation to misuse budgets, like interest rates, for political means. These proposals would make it embarrassing for the Chancellor to go for short-term pre election booms rather than long-term stability.

At present, the main political parties agree to the operational independence of the Bank of England and the MPC. Both the Conservatives, who were initially opposed to the independence of the Bank, and the Liberal Democrats, have suggested that the Bank should become more independent still.

3. Long-term interest rates

One immediate benefit that followed the establishment of the MPC was a reduction in the long-term interest rate. Investors, it is argued, require a rate of return (interest) that will take into account the expected rate of inflation. If this falls then the rate of interest required by investors also falls. In the case of overseas investors they also consider any relative movement between the value of their domestic currency and the currency in which the investment is denominated. In its May 1997 Inflation report[24] the Bank noted that:

> The immediate reaction of financial markets to the Chancellor's announcement (which was accompanied by a $^1/_4$% rise in official interest rates) was marked (see the table). That was most evident in long-term bond yields, which reflect expectations of inflation, real interest rates and risk premia. Long gilt yields fell by around 30 basis points. And, ten-year nominal forward rates-fell by about 50 basis points. Because real forward rates were broadly constant, this implies a corresponding fall in measured inflation expectations, the inflation risk premia or both. It seems likely that the changes to the UK monetary framework announced by the Chancellor have, at least for the moment, improved the credibility of monetary policy.

Change in UK financial market measures

	Fri 2 May (a)	Tues 6 May (a)	Change (b)
£ Effective exchange rate	99.71	100.56	0.85%
DM/£	2.80	2.82	0.82%
$/£	1.62	1.64	1.17%
Ten-year nominal forward rate	7.83	7.31	-0.52
Ten-year implied forward inflation rate	4.17	3.70	-0.47
Ten-year zero coupon rate	7.39	7.07	-0.32
Three month Libor (c)	6.53	6.53	0.00
FF-SE 100 index level	4,455.60	4,519.30	1.43%

(a) Close of business.
(b) Percentage points, unless indicated. Data are between close of business on Friday 2 May and close of business on Tuesday 6 May.
(c) 8.30 am rate, following business day.

[24] Bank of England, *Inflation Report*, May 1997.

4. Price stability

On the key point of whether the MPC has actually hit its stated inflation target the news is ambiguous. The inflation target that the MPC is required to meet is a 2.5% increase, over the previous twelve months, in the retail prices index excluding mortgage interest payments. Over the period covered by this Paper the following monthly inflation rates, on the stated basis, have been recorded:

RPI(X)
Annual Changes

		per cent	Meets target?	over/under target			per cent	Meets target?	over/under target
1997	June	2.7%	no	0.2%	**1999**	June	2.2%	no	-0.3%
	July	3.0%	no	0.5%		July	2.2%	no	-0.3%
	Aug	2.8%	no	0.3%		Aug	2.1%	no	-0.4%
	Sept	2.7%	no	0.2%		Sept	2.1%	no	-0.4%
	Oct	2.8%	no	0.3%		Oct	2.2%	no	-0.3%
	Nov	2.8%	no	0.3%		Nov	2.2%	no	-0.3%
	Dec	2.7%	no	0.2%		Dec	2.2%	no	-0.3%
1998	Jan	2.5%	yes	0.0%	**2000**	Jan	2.1%	no	-0.4%
	Feb	2.6%	no	0.1%		Feb	2.2%	no	-0.3%
	Mar	2.6%	no	0.1%		Mar	2.0%	no	-0.5%
	Apr	3.0%	no	0.5%		Apr	1.9%	no	-0.6%
	May	3.2%	no	0.7%		May	2.0%	no	-0.5%
	June	2.8%	no	0.3%		June	2.2%	no	-0.3%
	July	2.6%	no	0.1%		July	2.2%	no	-0.3%
	Aug	2.5%	no	0.0%		Aug	1.9%	no	-0.6%
	Sept	2.5%	yes	0.0%		Sept	2.2%	no	-0.3%
	Oct	2.5%	yes	0.0%		Oct	2.0%	no	-0.5%
	Nov	2.5%	yes	0.0%		Nov	2.2%	no	-0.3%
	Dec	2.6%	yes	0.1%		Dec	2.0%	no	-0.5%
1999	Jan	2.6%	no	0.1%	**2001**	Jan	1.8%	no	-0.7%
	Feb	2.4%	no	-0.1%		Feb	1.9%	no	-0.6%
	Mar	2.7%	no	0.2%		Mar	1.9%	no	-0.6%
	Apr	2.4%	no	-0.1%		Apr	2.0%	no	-0.5%
	May	2.1%	no	-0.4%		May	2.4%	no	-0.1%

Source: National Statistics First Releases, various dates

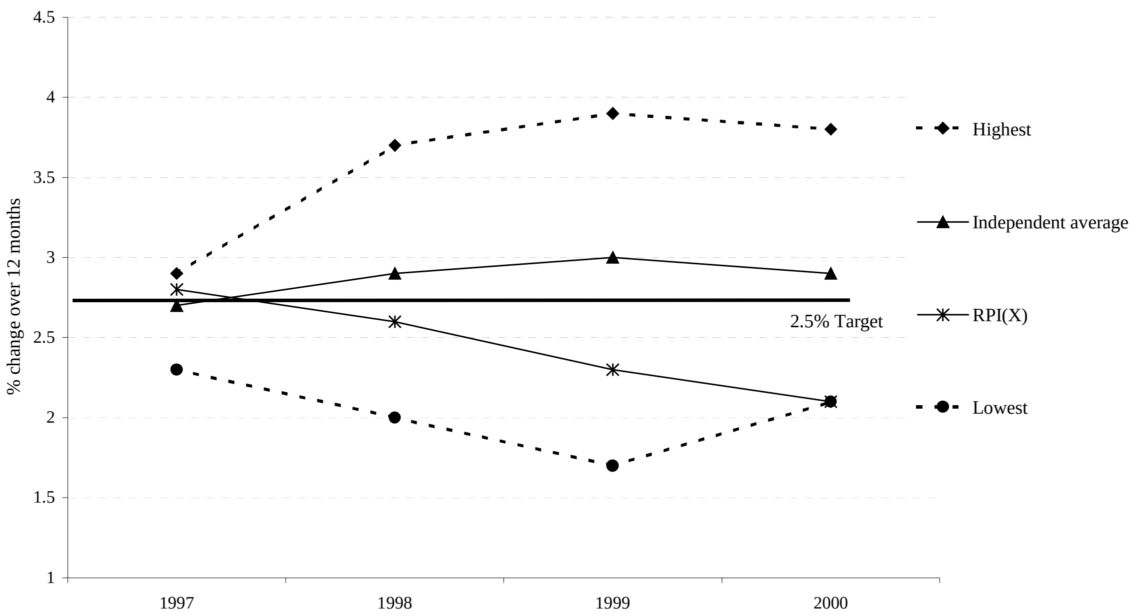
Is this good or a bad performance? Only four out of the forty-eight rates have met the target and thirty-five have been less than 0.5% away from the target. But, the last twenty-seven rates have all undershot the target and ten of the last fourteen rates have been 0.5% or more away from the target rate, suggesting that MPC policy may have been too ‘tight’. All the inflation rates are good by historical standards.[25] However, in the light of the downturn in both the UK and international economies and the general collapse in world commodity prices this has been a period in which background economic conditions have been conducive to low inflation.

Another way to compare the performance of the MPC is to compare inflation over the period with what had been the forecast immediately prior to its establishment. In the chart below, the actual average annual inflation rate RPI (X)[26] is compared to the average

[25] Long term RPI(X) is shown in chart form in Appendix I
[26] National Statistics First Release, 15 May 2001

and range of forecasts made by independent groups, themselves influenced by their state of knowledge about the then government's inflation target which, at the time, was a 1-2.5% target range.[27]

Forecast and actual annual percentage change RPI(X), 1997 to 2000



The chart confirms the view that inflation has been substantially lower than most forecasts predicted in 1997. However, it is still just within the range that economists, four years ago, thought it would be. Of course this type of comparison is as much a test of the predictive abilities of a particular group of economists as it is of the MPC, indeed, perhaps, a greater test.

5. Secondary objectives[28]

As set out in the Section 11 of the *Bank of England Act 1998*, subject to maintaining price stability, the secondary objectives of the MPC are;

> to support the economic policy of Her Majesty's Government, including its objectives for growth and employment.

Since the MPC was set up, gross domestic product (GDP) at constant market prices has grown by an average of 0.7% per quarter. In the same time period prior to the MPC being set up, GDP at constant prices grew by an average of 0.8% per quarter, although the actual difference in the average growth rate of GDP at constant prices is less than

[27] HM Treasury, *Forecasts for the UK economy: A comparison of independent forecasts*, No 121, May 1997

[28] Long term GDP and employment data are shown in chart form in Appendix II

0.04% per quarter.[29] Employment over the period has risen by just over 4%[30] while unemployment, depending on the definition, has fallen by between 30% and 38%.[31]

These figures suggest that the MPC has achieved its' primary objective of price stability whilst growth has remained relatively constant and employment has risen, thereby also achieving its' secondary objectives.

29 National Statistics database, series CAOB

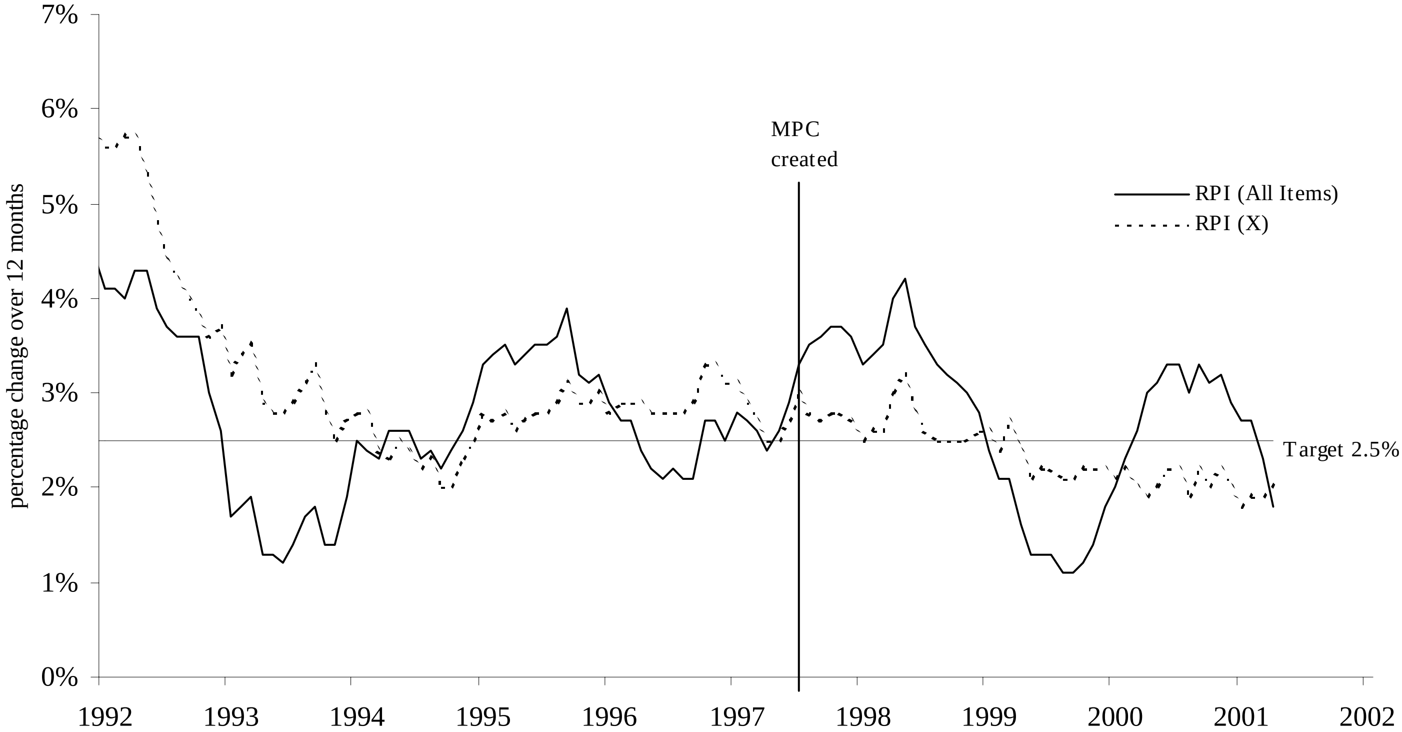
30 National Statistics database, series MCRZ

31 ILO Unemployment and Claimant count unemployment respectively, National Statistics database series, MGSC, BCJD

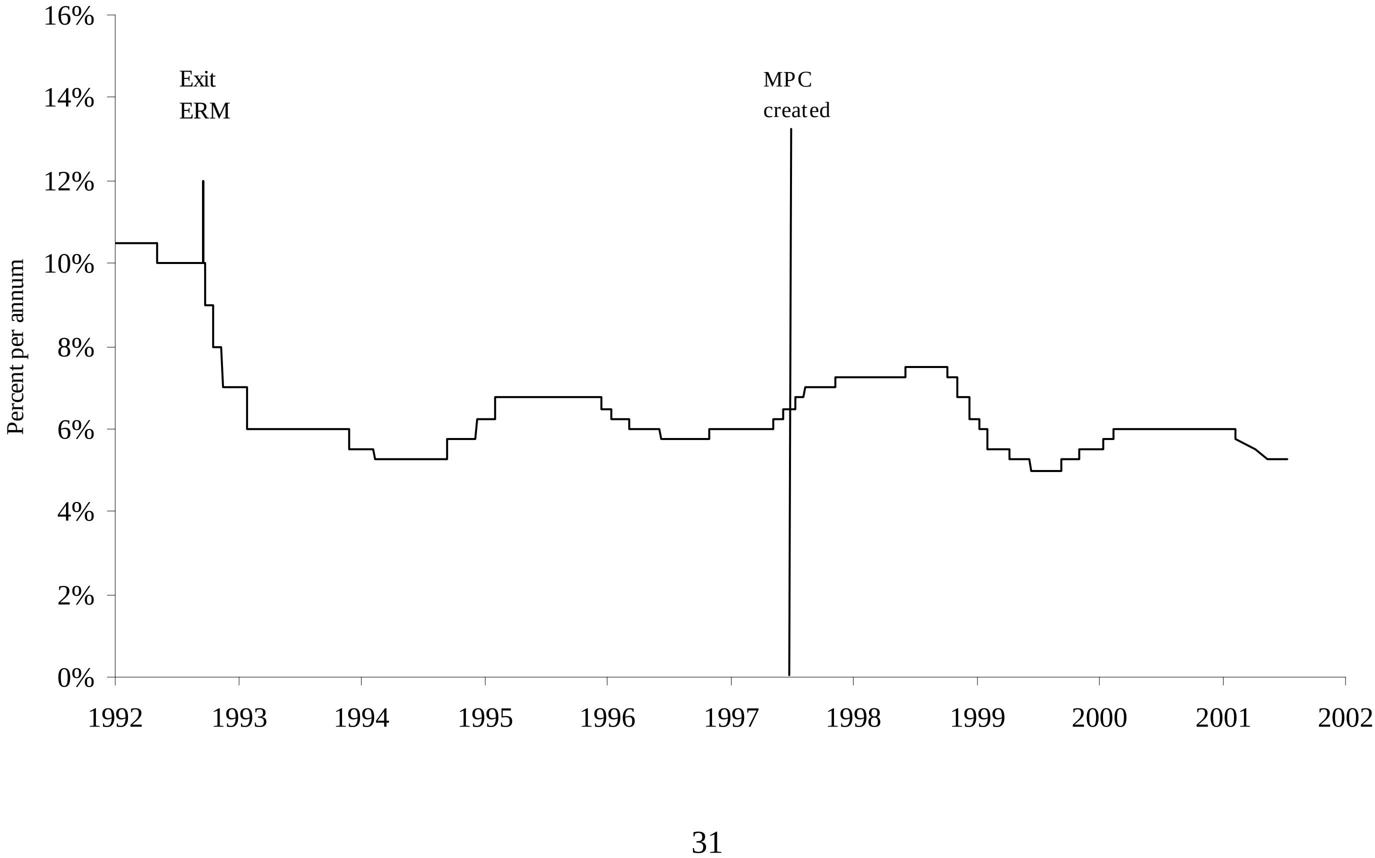
Appendix I: Inflation & Interest Rates

Indicators of inflation and interest rate performance are shown in the charts below:

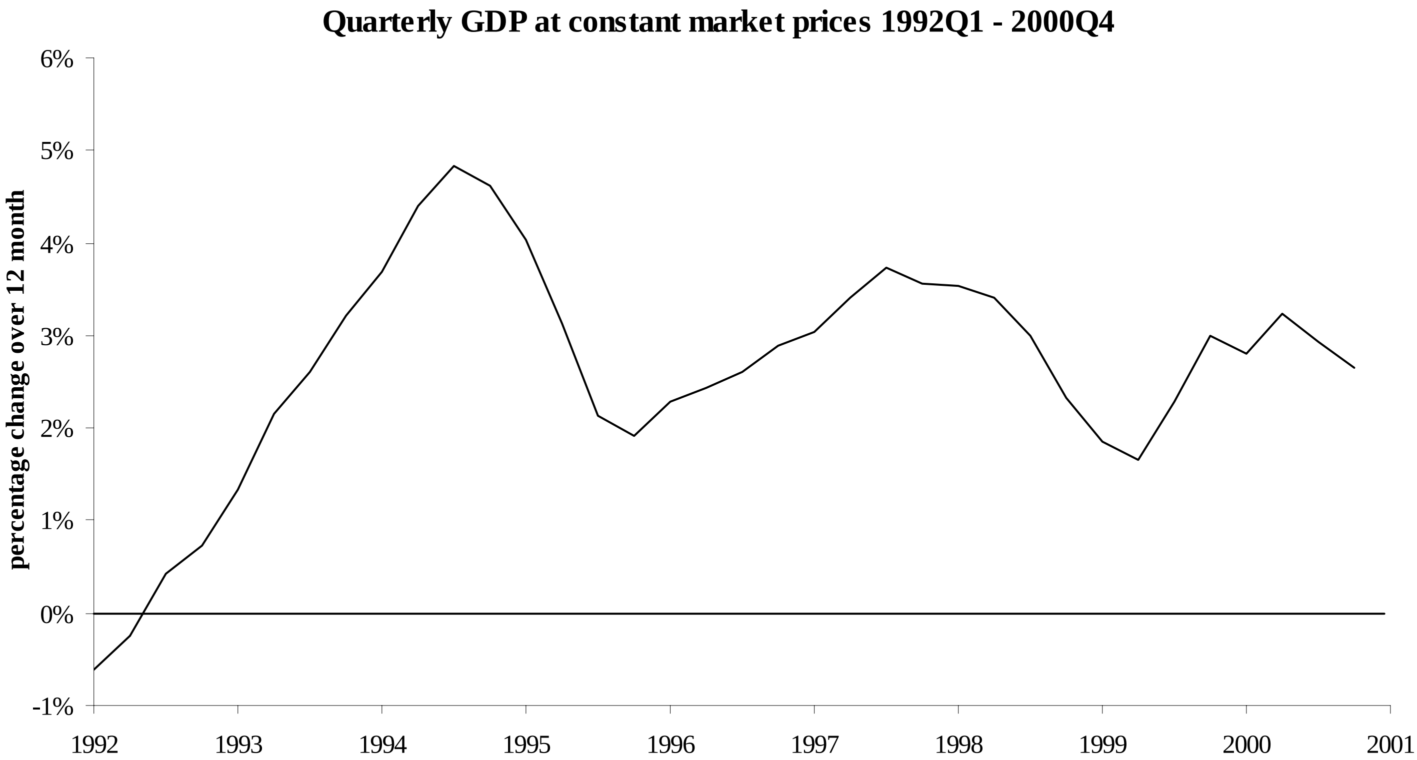
Retail Prices Index 1992 - 2001

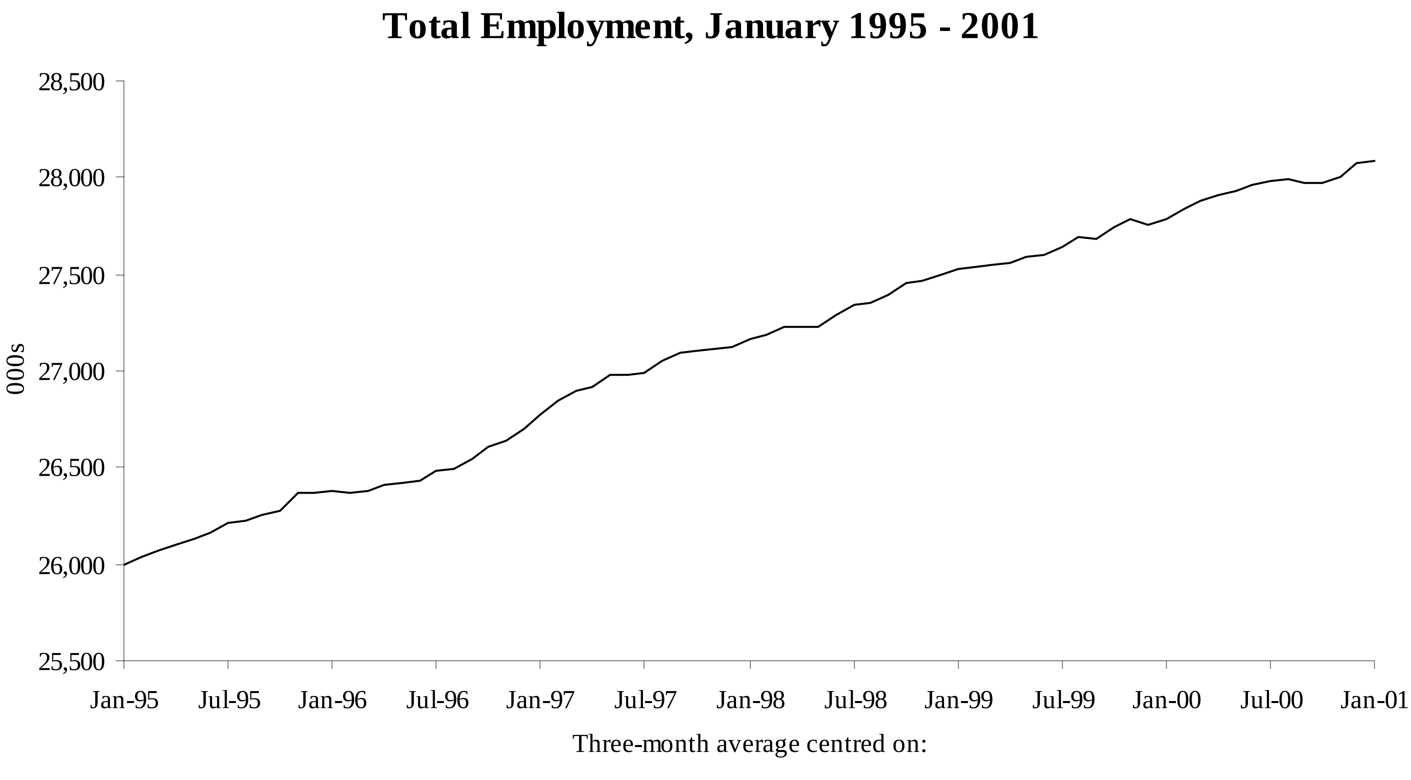


Base / Repo Rates 1992 -2001



Appendix II: GDP and employment





Appendix III: Further Reading

Members interested in further analysis of the operation of the MPC and the determination of monetary policy in general may find the following references helpful.

Bank of England material

- Speech by Eddie George '*The objectives and current state of monetary policy*', printed in the *Bank Of England Quarterly Bulletin*, November 1998
- Speech by Sir Alan Budd *'Economic Policy, with and without forecasts'*, printed in the *Bank Of England Quarterly Bulletin*, November 1998
- Speech by Mervyn King *'Monetary Policy and the labour market'*, printed in the *Bank Of England Quarterly Bulletin*, February 1999
- *Economic Models at the Bank of England*, April 1999 & *Economic Models at the Bank of England - September 2000 Update*, September 2000 available on the Bank's website as at 15 May 2001: www.bankofengland.co.uk/Links/setframe.html
- *The transmission mechanism of monetary policy*, The Monetary Policy Committee, 1999, available on the Bank's website as at 15 May 2001: www.bankofengland.co.uk/montrans.pdf
- Donald L. Kohn, *Report to the Non-Executive Directors of the Court of the Bank Of England on Monetary Policy Processes and the Work of Monetary Analysis*, October 18, 2000 available on the Bank's website as at 15 May 2001: www.bankofengland.co.uk/kohn.pdf
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