Minutes of the meeting of 15 April 2025 Institute of Economic Affairs (hybrid meeting

Attendance: Juan Castaneda (online), Julian Jessop (online), Andrew Lilico (Chair), Kent Matthews (Secretary), Patrick Minford (online), Trevor Williams,

Apologies: Roger Bootle, Tim Congdon, Graeme Leach, Peter Warburton

Chairman's comments: With the joint Chairmanship ending for the current term, Andrew Lilico passed on the responsibility of the Chair to Trevor Williams. Trevor Williams thanked Andrew Lilico for his Chairmanship and welcomed the members online and invited Julian Jessop to present his assessment of the economic and monetary situation.

The World before Liberation Day

Julian Jessop thanked the Chairman for the opportunity to present his thoughts to the committee and set out the agenda for the structure of the presentation. He said that he was going to talk about the economic outlook before Liberation Day, provide an update on the UK economy, but the obvious talking point is the latest news about tariffs. He said that he was starting from the position as of two hours ago but that anything could change. He said that he will discuss how central banks should respond, and finally, he will present his own views on the immediate policy decisions subject to the the discussion following his presentation.

Starting with where we were in March, the global economy was growing at a steady pace. The Global PMI output index was consistent with global GDP growth of around 3%, and so was close to trend. Services were growing relatively strongly, but manufacturing continued to lag behind. Firms' expectations for their own output over the next 12 months were already faltering, well before Liberation Day. Firms had begun to worry about rising input prices, mostly labour and energy, but also other materials. So things were beginning to look shaky ahead of Trump's announcement.

On the positive side, he said that there were signs of life in the euro economy. The IFO survey of the German economy, although subdued, was showing signs of picking up early in the year. That has been helped by a reduction in political uncertainty following the federal elections and the planned loosening of the fiscal rules. There is plenty of scope for demand stimulation even at the cost of higher interest rates evidenced by the jump in bond yields.

He said that the picture for the US economy was mixed. The Atlanta Fed's latest NowCast suggests that US GDP will fall at an annualised rate of about 3% in Q1. The key driver is the possibly temporary jump in imports to beat the tariffs deadline, including a huge increase in the imports of gold. But other key components are still positive and so it is not a recession signal yet. Nonetheless, recession fears have contribuied to a further deterioration in consumer and business confidence. He said that it might be hard to interpret quarterly figures as imports may jump back in Q2, and US exports have suffered also with services exports being affected by a fall in tourism. There will be a lot of volatility in the quarterly output figures.

In contrast, the UK economy appears to be bouncing back. Julian Jessop said the February monthly GDP number turned out much stronger than expected. GDP jumped by 0.5 per cent and even on a 3-month on 3-month comparison which is supposed to strip out volatility, the figure was 0.6 per cent. He said that he was wary of the monthly numbers as they are inherently noisy. The figures could also have been distorted by tariff effects with production of metals coming forward to avoid the tariffs. But there are signs of strength in consumer spending on services as consumers have benefited from rising real incomes. He said that consumer spending could remain strong for the rest of the year if nothing knocks it off course and he would not completely dismiss the strength in the GDP numbers.

Julian Jessop said that there are reasons for optimism in the surveys. He referred to the chart of the PMI output index matched against GDP. He said that has been a pickup the PMI output covering private services and manufacturing. Although the PMI figures are not a perfect match against the GDP numbers and do not match a 0.6 per cent rise in GDP 3-month on 3-month, there are other green shoots like the BRC survey of retail sales. He said that there are some reasons in the surveys to believe that the UK economy is doing better but nowhere as strongly as the official GDP figures suggest. He said that the recovery still looks fragile.

One thing that was already doing badly is the labour market. Focussing on the PAYE data from HMRC, there was a sharp drop in payroll employment by 78,000 in March. Payroll employment had fallen in six of the last nine months. The March figures are just ahead of the rise in costs of employment that will kick-in in April. He said that the payroll numbers include the public sector. Although he has not constructed the numbers, he said that he thinks the private sector would show a sharper fall. Despite the slowdon in the labour market, headline pay growth is still quite strong at just under 6 per cent but leading indicators and surveys of wage expectations suggest a weakening. One reason for this mis-match is timing, with pay growth lagging activity in the labour market. A second issue is causation with companies paying or antipating paying more with the increase in the national minimum wage contributing to labour market weakness. Leading indicators suggest that pay rises in the next year are likely to be softer, with rises of 3-4%, which is consistent with an inflation of 2%.

Julian Jessop said that almost everyone expects inflation to jump again in April and peak around 3¾ per cent in the summer based on what is already known about the pass through of higher labour costs and energy prices. Importantly, everyone expects inflation to drop back sharply after that. The Bank of England, OBR , and independent forecasters are similar in this. A further point is that money growth is not a major inflation threat. UK broad money growth has picked up to around 4%. Julian Jessop said that this figure should be stronger to be comfortable with improved economic activity, but it is not rapid enough to be concerned about a sustained increase in inflation.

The World after Liberation Day

Julian Jessop said that the US now has a bewildering array of different tariffs for different countries and for different goods, and even the same goods from different countries. There are various sector specific tariffs. The 25% on cars is the best known one. There are punitive tariffs on China as high as 145%. There are reciprocal tariffs on almost everyone else, which he said that he would comment on further, but mysteriously some countries including Russia are exempted. There is also a wide range of discounts and exemptions on pharmaceuticals, fuels, and some electronic goods – even from China.

Julian Jessop said that it is hard to calculate what the effective US tariff rate is, but his estimate is that the effective tariff rate has increased from around 3% to above 20%. He said that he wanted to say more about reciprocal tariffs. What are they? These apply to most countries, but Russia is excluded, and the Falkland Islands and various uninhabited islands in Antarctica are included. The aim is to find the tariff rate that in principle balances bilateral trade in goods with each country, then apply half that rate. However, there are exemptions. Where the US runs a surplus like with the UK, a baseline tariff of 10% would apply. Where the US runs a deficit, a higher tariff applies. The larger the deficit, relative to a country's total trade in goods with the US, the higher the tariff. Trump has suspended the higher rates for 90 days, but the 10% general tariff still applies. So, for the UK, the general 10% tariff applies but the 25% car tariff also applies.

Julian Jessop asked, does this make any sense? He said of course not. The US has assumed that there are loads of non-tariff barriers, from currency manipulation, to regulations, and subsidies and dumping exists but rather than measure these directly they assume that the size of a bilateral trade deficit is a proxy for the artificial trade barriers that exist. Clearly the theory of Comparative Advantage does not say that there will be balanced trade in goods between each and every country. Services are ignored in the complete process. Some of Trump's supporters acknowledge this but they argue that it is all a cunning plan to bring countries to the negotiating table.

Julian Jessop said that he does not buy the argument that this is all in the 'Art of the Deal'. He said that the current US position is simply unsustainable, and that Trump will have to continue to back down. The adverse reaction of equity but especially bond markets shows that the policy lacks credibility. He said that even the general public are starting to get worried about this. The University of Michigan survey of consumer confidence show that American consumers are much more worried about jobs than a few months ago. That is in addition to the jump in inflation expectations that will make it harder for the Fed to cut interest rates.

The silver lining is that American business hates it, the markets hate it, the public hate it. Which means that Trump is going to keep backing down and the policy is not sustainable. What does this mean for the UK? Julian Jessop said that the OBR modelling suggest that a global trade war with US tariffs of 20 percentage points higher than before could reduce UK GDP by as much as 0.6% in 2025 with a peak of 1% in 2026. However, this is a worst-case scenario that assumes other countries including the UK retaliate. And even this would not be enough on its own to drag the UK into a full-blown recession.

Julian Jessop said that he had two illustrative scenarios. In his central scenario, the trade war is largely contained to the US and China. UK consumer spending continues to recover as real income rises, public sector investment kicks in, and taxes are not raised further. In that scenario, he said that he saw 1% growth this year picking up to about 1.5% next year. But all the main risks are on the downside. His alternative scenario is one where there is a short-term recession and only a partial recovery next year.

Julian Jessop posed the question, how should central banks respond? Just about everyone thinks that the central banks should cut interest rates. But this is not so clear cut. The Bank of England has examined the impact of a trade war on inflation and growth and the UK interest rate decision. There are lots of uncertainties about the impact of a trade war that might affect both aggregate demand and aggregate supply leaving the effect on inflation unclear. Given that the Bank of England mandate is for inflation and not growth, the key takeaway is that central banks may wish to wait and see the effects before responding.

Julian Jessop said that one effect seems to be clear and that is global oil prices have fallen sharply in the last few weeks, and although there has been some recovery, but retail fuel prices can be expected to drop further in the next few weeks.

Natural gas prices have also fallen. Based on where the markets currently are, if the Bank and OBR were to do there forecasts again, they would expect inflation peaking nearer 3% than 4%.

He said that the effect of tariffs on inflation in the US would be positive but probably negative in the UK. So, the Fed has a bigger problem with inflation than what we have over here. But the Fed has a dual mandate, and they would be more willing to look at any weakness in the real economy, particularly if unemployment rises. He said that he didn't think it likely that the Fed would cut rates. What this means for the UK is in one sense irrelevant because the mandate of the Bank is different from the Fed. But it may matter depending on the implication for sterling and the bond market. So, if the Fed cuts rates and that is positive for the pound, it means that the Bank is more likely to cut rates.

Julian Jessop said that his policy recommendation is for an immediate half point cut in Bank rate to 4%, to return official interest rates to a neutral level and no bias thereafter. He said that 4% is a sensible level of the rate of interest. He said that he would have voted for this irrespective of what Trump has done. He said that interest rates have been higher than what they need be to bring inflation down. Nonetheless he is now more confident about voting for 50 bps cut because of the impact of the trade war which will have a downward effect on inflation both from energy prices and trade diversion from China. He said that he would pause QT pending a wider review of the treatment of the Asset Purchase Facility in the Bank's balance sheet and of the amount of interest paid on QE reserves.

Discussion

Trevor Williams thanked Julian Jessop for his presentation and asked if there are questions from those online.

Patrick Minford said that he thought Julian Jessop summed up the situation well. He said that he broadly agreed with the policy discussion and not just for the reasons he gave. He said that the money supply figures suggest that we should be cutting rates and we should be expecting inflation to fall towards its target. Patrick Minford said that he was always in favour of reform of the way bank reserves were treated. He said that to pay something like £40 bn on bank reserves is quite mad. As far as valuation of bonds in the Bank of England balance sheet occurs, as it is in the public sector, this washes out inside the public sector. He said that this was an irrelevant discussion. What is important is the rates should come down and there should be minimal disturbance to the gilts market at the long end by QT. He said that he agreed with Julian Jessop's policy recommendation and had no bias but to move monetary policy quickly.

Juan Castaneda said that he also agreed with Patrick Minford and Julian Jessop's position. Based on the money numbers, the money supply has picked up in the last month. The latest growth figure is for January which showed M4X growing at 4.2% which is getting closer to something more compatible with a 2% target. He said that he would be in favour of a greater rate of growth of money in the 4.5 – 5.0% range, and he would be in favour of cutting rates by 25 bps and halting QT so that M4X keeps a steady growth in the above range for the next few.

Andrew Lilico asked Juan Castaneda what does monetary theory say about a world with negative supply shocks from tariffs and a reduction in trade, for the relationship between money growth and inflation? He said that we have got used to the idea that 4.5-5.0% broad money growth is consistent in the medium term with a 2% inflation target. Would the money growth – inflation relationship change if there was a disruption to trade? Juan Castaneda said that if the trade war results in a lower rate of growth of GDP, then we will need to have a lower rate of growth of broad money to keep inflation at 2%. Andrew Lilico asked if monetary theory said anything about trade and expectations of how long the trade distortions would last that might affect the monetary relation. Kent Matthews said that it depends on expectations of how long the trade retrictions would be expected to last. Money being a temporary abode of purchasing power would be held in anticipation of future expenditure, and therefore that only affects the short-term dynamics. If the trade restriction is assumed to be permanent, there will be a period of adjustment that might result in higher inflation if money was not held but spent, but in the long-term, money growth would stay the same as the level of potential GDP falls but long-term GDP growth is restored according to fundamentals. Trevor Williams said that there was another angle to this. If there was a restriction on the open account and that the balance of payment was unable to balance domestic saving with investment which restricts access to liquidity to fund investment, he asked what the implication is for monetary growth? Patrick Minford said that the money stock is isolated from the rest of the world by the exchange rate and the simple view is that that we should try to maintain the growth in money supply. He said that Trump is going to hit mid terms that is going to be very hostile and cause a fracturing of these policies by the Republican Party. Trevor's view was that we would have to ease domestic monetary policy to try and offset tigher external conditions implied by tariffs.

Andrew Lilico questioned Julian Jessop that if money growth picks up to close to the range we need for target inflation, why do we need a 50 bps cut in interest rate now? Why don't we just let the money supply growth rise as it appears to be doing and settle at the range consistent with the inflation target? Trevor Williams said that he did not think that the rise in money growth would persist as this may have been cause by temporary factors relating to the rise in mortgage demand to beat the increase in stamp duty and the rise in demand for credit by the small business sector that will be reversed given the shedding of labour. Julian Jessop said that another factor is that market interest have fallen on the anticipation of the Bank cutting interest rates. If the Bank of England does not cut interest rates, market rates would rise choking off the rise in money growth. He said that his recommendation to cut rates is partly to validate what the markets have already assumed. He said that money growth need to be closer to 5% but also interest rates matter and these should be 4%. Patrick Minford said that interest rates need to react to the weakness in the labour market.

Trevor Williams asked Julian Jessop why he thought 4% interest rates was the neutral rate of interest? Julian Jessop said that he was taking long-run inflation to be 2-3% and growth of real GDP in the long-run to be in the range 1-2%. He said that he was more optimistic about long-run GDP growth and equilibrium real rates of interest of about 2% is about right. Juan Castaneda said that money growth has for a long time been well below the range consistent with the inflation target and only recently started to rise. There has not been a systematic growth in the desired range and so there is some margin for money to stabilise. Trevor Williams asked Juan Castaneda why he is recommending only a 25 bps cut. Juan Castaneda said that his timidity was becuase he wanted to stop QT first and see the effect before commiting to larger interest rate cuts.

Andrew Lilico said that one of the arguments for cutting rates in the previous meeting was that long rates were below short rates, indicating the tightness of monetary policy. But long rates today are higher than short rates and 10-year rates are about the same level as short rates. This means that we should hold off further cuts in rates. Julian Jessop said that one reason as to why long rates have risen is because there is a higher risk premium for UK fiscal policy.

Trevor Williams asked for a formal vote. Kent Matthews said that Julian Jessop had indicated his vote in the presentation. Patrick Minford and Juan Casaneda have already indicated their respective votes. Patrick says 50 bps and pause QT. Juan says cut rates by 25 bps and stop QT.

Votes.

Votes are recorded in the order they were given.

Comment by Julian Jessop

(Independent Economist)

Vote: Cut in Bank Rate by 50 bps. Pause on QT.

Bias: No bias

Comment by Patrick Minford

Business School, Cardiff University)

Vote: Cut in Bank Rate by 50bps. Pause QT.

Bias: No bias.

Comment by Juan Castaneda

(Vinson Centre, University of Buckingham)

Vote: Cut in Bank Rate by 25 bps. Halt QT.

Bias: No bias.

Comment by Andrew Lilico

(Europe Economics)
Vote: to HOLD Bank rate at 4.5 per cent. To pause QT
Bias: No bias

The economy has been on a money roller coaster and now he is not inclined to fit in with the rest of the committee. He said that he was not inclined to change anything, partly because money growth is nearly at its desired rate of growth and partly if money growth declines that would also be consistent with a slower growing economy consistent with the inflation target. Cutting in that environment means that you end up overshooting your inflation target. There is also a lot of uncertainty and is inclined to keep his powder dry because of uncertainty. The uncertainty is about what the right monetary policy should be given the changing environment. He said that he votes for a hold in the Bank rate. No change in QE and no bias.

Comment by Kent Matthews

(Cardiff Business School, Cardiff University)

Vote: To cut Bank Rate by 50 bps. To pause QT.

Bias: No bias.

Kent Matthews said that at the previous meeting he voted to cut Bank rate by 25 bps because he expected to see a more pronounced fall in the growth of the economy given the sharp fall in money growth in the previous months. That did not happen, and he said he was cautious about the cut in Bank rate. However, the increase in uncertainty created by the Trump pronouncements is of such an order that it is affecting consumer and investor confidence. There is a need for monetary policy to react more than a cautious 25 bps cut. He said that he votes for a 50-bps cut in Bank rate and to pause QT.

Comment by Trevor Williams

(University of Derby, TW Consultancy, and FXGuard)

Vote: Cut Bank rate by 50 bps. To continue QT

Bias: to cut rates further

Trevor Williams said that he agreed with many of the points made. He agreed that there is greater uncertainty. There is also a tighter fiscal stance. He said that households have increased their precautionary savings. The fall in the employment levels is a sign of contraction as firms react to the tax on jobs and increase in the living and minimum wage. Growth will slow as a consequence. There have also been tax rises in other areas, not just the ones on employment. Council tax has risen faster than inflation in some places and matched inflation in others. The external environment matters to the UK as we are a net borrower from the rest of the world and are deeply affected by what happens. GDP growth is likely 1% this year and the same next year. He said this warrants a cut in the Bank rate by 50 bps.

Regarding long-term rates, he agreed with Andrew Lilico that continuing to offload the stock of bonds may not be a good idea, but he wanted the flexibility to use QE again if we needed it. For that reason, he said QT should be maintained. He said that his bias is to ease another 50 bps at the next quarterly meeting or before if economic conditions worsen. He said that in his view, the neutral rate is around 2.75% to 3%.

Comment by Graeme Leach (in absentia)

(Macronomics)
Vote: To cut Bank Rate by 50bps. Hold QT
Bias: No bias.

The downward shift in business and consumer confidence in the wake of the tariff wars necessitates swift countermeasures on the part of the Bank of England. Even though a 90-day tariff pause is in operation, underlying damage to business investment and consumer purchases of big-ticket items is likely to intensify. There were some fragile signs of green shoots in the UK prior to liberation day but these are likely to have been snuffed out subsequently. Consequently a 50-basis point reduction in interest rates is required. Money supply growth remains weak and so there is little inflationary threat. Surveys of wage expectations are weakening. Inflation is expected to rise in April, primarily due to energy price effects, but the Bank of England is likely to look through this and reduce rates.

Comment by Tim Congdon (in absentia)

(Institute of International Monetary Research, University of Buckingham)

Vote: To cut Bank rate by 25bps.

Bias: No bias.

President Trump's erratic conduct of US policy affects the UK, as of course it impacts on all countries. However, broad money growth is low and steady in most of the advanced world, and the USA accounts for under 15 per cent of the world's imports. A recession in Europe and the UK should be avoided, but the bias of policy should be towards ease while so many uncertainties affect the economic outlook

Comment by Peter Warburton

(Economic Perspectives Ltd)
Vote: To cut Bank rate by 50bps and end QT
Bias: To cut.

The global economic outlook has soured considerably since the Trump administration announced a slew of US tariffs on 2 April, notwithstanding the backtracking a week later. On the most favourable scenario, these tariffs will be almost fully revoked by the end of June, leaving a heavily disrupted Q2 and Q3, given the typical length of time taken for trans-pacific transport of 30-45 days. If the primary disruption is to supply, as it would appear, then we face the combination of a negative output shock and a positive price shock. Ordinarily, the Bank of England might disregard both shocks, if they were confident that would be short-lived. However, the risks to activity – and lending by banks and capital markets - are skewed to the downside, partly because of the paralysis of business decision-making. A second factor is the unwanted strength of Sterling, as a by-product of US policy turmoil and the repositioning of assets. This justifies a stronger response. My vote is to cut Bank Rate by 50bps, end QT and with a bias to further Bank Rate cuts

Any other business

There was no other business, and the Chairman called the meeting to a close.

Policy response

1. On a majority vote, the Committee recommended a cut to Bank rate of 50 bps and a pause or halt to QT.
2. Six members voted a cut of 50 bps, two for a cut of 25 bpd and one recommended a hold.
3. Seven members voted to end or pause QT with one member voting to continue and one member expressing no preference.
4. Two members expressed a bias to cut Bank rate further with seven recording no bias to further cuts.

Date of next meeting

15 July 2025

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 quarterly meeting held by the SMPC.

Current SMPC membership

The Secretary of the SMPC is Kent Matthews of Cardiff Business School, Cardiff University, and its Rotating Chairman is Andrew Lilico (Europe Economics) and Trevor Williams (TW Consultancy, University of Derby). Other members of the Committee include: Philip Booth (St Mary’s University, Twickenham), Roger Bootle (Capital Economics Ltd), Tim Congdon (Institute of International Monetary Research), Jamie Dannhauser (Ruffer LLP), John Greenwood (International Monetary Monitor), Julian Jessop (Independent Economist), Graeme Leach (Macronomics), Patrick Minford (Cardiff Business School, Cardiff University), Peter Warburton (Economic Perspectives Ltd), Mike Wickens (University of York and Cardiff Business School), Juan Castaneda (Vinson Centre, University of Buckingham).