

## Minutes of the meeting of 15 July 2025 Institute of Economic Affairs (hybrid meeting)

**Attendance:** Roger Bootle, Tim Congdon, John Greenwood (online), Graeme Leach, Andrew Lilico, Kent Matthews (Secretary), Patrick Minford, Trevor Williams (Chair), Shamik Dhar (Independent Economist - Guest)

**Apologies:** Juan Castaneda Julian Jessop, Peter Warburton

**Chairman's comments:** Trevor Williams messaged that he would be a few minutes late. In his absence Andrew Lilico opened the meeting and invited Graeme Leach to present his assessment of the economic and monetary situation.

### International Outlook

Graeme Leach began his presentation with an evaluation of the global inflation situation. He discussed the broad trends in money growth of the major economies. He said that annualised money growth in the latest 3 months in the USA was up as Trump eased bank capital rules and through some monetisation of the Federal deficit. Elsewhere in China, money growth remains low despite central bank and government stimulus. Inflation there is negative. In the Eurozone, money growth is low but satisfactory, and inflation is down towards the target. In Japan, money growth is negative and vulnerable to increases in interest rates. M4x growth in the UK slowed in April. Graeme Leach stated that UK inflation is above target, but it is expected to decline in the second half of this year and into next year. The upshot is that inflation is very much yesterday's story, as a result of the money turnaround over recent years.

Graeme Leach stated that, in his view, inflation was not the problem. The latest US figures show inflation at 2.7 per cent, but that is not a problem, since it is likely to fall back from now on. The Fed is concerned about the effects of tariffs, whether they will be permanent or temporary. However, as repeatedly stated in SMPC minutes, the Fed doesn't consider money supply growth and thus misses the point that, in the absence of any monetary acceleration, tariff effects will only be temporary. Moreover, commodities such as oil, at \$70 per barrel, also support the case that inflation is yesterday's problem. A similar benign inflation threat can be seen in the Eurozone, where inflation is on target.

Graeme Leach said that to understand what lies ahead, it is helpful to look back through the rear-view mirror in order to understand what he termed the great escape. He said that if we look back to early 2022, there was clear evidence of a classic bubble economy in US asset markets, demonstrated by the charts of the Shiller PE ratio and the Wiltshire 5000 to GDP ratio. The bubble economy was present before the Pandemic, but intensified thereafter by the monetary explosion that occurred during COVID. He said that Pandemic money supply growth was the culmination of possibly the greatest spell of easy money in history, coming to an end, as measured by QE and ZIRP, and the malinvestment that resulted from that process. That all came to an end in September 2022 to July 2023, when the Fed increased the Fed Funds rate by 300 bps. The yield curve inverted, and suddenly a day of reckoning looked likely, and even more so in early 2023, when there was a mini banking crisis in the US. But surprisingly, this quickly became the dog that didn't bark. The reason being twofold: (1) The FDIC guaranteed deposits above \$0.25 million. (2) The Fed guaranteed Treasuries and mortgage securities at par through the Bank Term Funding Program. He said that we tend to forget just how big these decisions were. At one stage, the BTFP reached \$160 billion per week, but ended in March 2024.

Graeme Leach suggested that there are six reasons why the US didn't experience a recession. Moreover, there was considerable overlap between them. First, there was the monetary overhang from the Pandemic. Money supply growth slowed dramatically over 2023-24, but the sheer scale of money growth previously left an overhang that continued to stimulate economic activity in the short term. Second, the forced savings which occurred during the Pandemic meant that households had more resources with which to deal with subsequent rising interest rates. Third, the sheer scale of fiscal largesse, with budget deficits exceeding 6% of GDP at near full employment in 2023-24. Graeme Leach noted that even Keynes would have argued for a budget surplus, not a deficit, at full employment. Fourth, the impact of the interest rate rises was muted by the scale of remortgaging during the Pandemic. A huge number of homes had been remortgaged when rates were much lower. Fifth, there were considerable wealth effects from asset markets. Sixth, all the above combined to keep unemployment around 4%. Then, the Fed began reducing rates by a cumulative 100 basis points from September 2024 onwards. These provide strong reasons as to why the US avoided a recession after the tightening in monetary policy following the great post-pandemic inflation.

But another factor needs also to be considered, namely the historical predictive power of the yield curve. Conventionally the inverted yield curve is viewed as a good predictor of recession, but an examination of the charts shows that US recessions come after the uninversion of the yield curve. So potentially there could still be a problem, but this time it is on a long lag.

However, the consensus of forecasts is that the US has escaped recession. The clustering of forecasts indicates growth in the 1.5% to 2% range and unemployment at 4.5%. The market expects a further 100 bps cut in the Fed Funds rate. So it seems that the USA may have escaped. One also has to consider Trump's pressure on the Fed to lower interest rates even further – although that could backfire if it spooks the markets.

Regarding the fiscal deficit, projections indicate an increase in the deficit over the next decade of approximately \$2.4 trillion. He said that if you take the tax cuts as permanent and higher debt servicing of \$0.7 trillion, the cumulative increase in the deficit rises from \$2.4 trillion to \$4.5 trillion. Graeme Leach said there is an argument for offsetting dynamic effects but that he was not confident that future spending – and therefore higher deficit – commitments from Capitol Hill would not swamp any positive dynamic effects. He said that bond markets are beginning to realise what they should have seen years ago regarding US fiscal incontinence. There is a danger that US Treasuries will no longer be perceived as the world's safest asset. Graeme Leach said that the scale of economic uncertainty meant that there were at least five potential scenarios to consider.

Scenario 1 is the wild-card scenario, a possible but low-probability outcome. The unexpected scale of reshoring, driven by tariff pressures, pushes up US investment and business confidence, while also reducing unemployment in 2025-26. In this scenario, GDP accelerates towards 3% or higher in 2025-26. Scenario 2 is the Great Escape story. This is the consensus expectation for 1.5-2.0% growth in 2025. Scenario 3 is a reckoning scenario, with 0.5% - 1.0% growth in 2025. This is the scenario in which the consequences of easy money over the past decade come home in the form of a sharp reduction in asset values, which then undermine the economy and the financial system. Scenario 4 involves a resumption of the tariff wars, accompanied by higher inflation and limited Fed Funds rate reductions. This could combine with the tariff wars in scenario 3 to worsen the reckoning scenario. The fifth scenario adds even more complexity and uncertainty. This is a tariff war amid a Chinese economic crisis, characterised by a simultaneous slowdown/recession in the world's two largest economies. In a worst-case scenario, the situation could become very dire if a Chinese economic crisis coincides with the reckoning scenario and tariff wars.

The reckoning scenario suggests that the US bubble economy remains intact. The 10-year moving average of the Shiller-PE ratio has bounced back after the earlier tariff-triggered retreat. The Wilshire 5000 is off the scale at 200, when the long-term average is 90. Graeme Leach said that this is still a bubble economy. On the extended lag on the yield curve prediction of recession, Graeme Leach said it was still plausible. Moreover, another possible warning came from the scale of repo market activity and securities purchases, which was reminiscent of 2007-8.

Graeme Leach said that he had focused on the US in his presentation, as what happens there influences what happens here. If the tariff rate exceeds 20%, it will raise effective tariff rates to 1930s levels. This will have knock-on effects on consumer sentiment. When tariffs were introduced earlier this year, the Michigan Consumer Sentiment Index plunged. It has recovered somewhat in the past month, but could easily slip back very quickly. Adding this to weakened business sentiment would seriously challenge the consensus view of the outlook.

Graeme Leach finished his assessment of the global economy by referring to the Triffin economy (after the Belgian American economist, Robert Triffin, who first advanced the idea). As the US dollar serves as a global currency, it operates differently from other currencies. Trade deficits haven't devalued the currency, thereby reducing the imbalance. In a Triffin economy, the world's demand for American financial assets—T-bills and Treasuries—means that it is difficult, if not impossible, to narrow the trade deficit. Moreover, in a Triffin world, as the US share of global GDP declines over the long term, the absolute level of the US trade and budget deficit imbalance will need to widen to provide the necessary financial assets to support dollar-based trade. Markets appear to be waking up to this possibility at the same time as recognising US fiscal incontinence.

### **UK Economic Environment**

Turning to the UK economy. Graeme Leach said that the GDP monthly tracker data for April and May was not great. There was a drop in May, driven by declines in production and construction. In April, it was the services sector that dragged down output. The median forecast of the Treasury panel of forecasters in June was for 1.2% GDP growth in 2025 and 1.1% next year. This, of course, does not take into account the potential resumption of tariff wars.

Combined with this immediate threat, Graeme Leach asserted that there was a creeping longer-term problem of declining potential output, due to a trade-off between the growth of the state and GDP growth – more government means lower growth, and vice versa. Graeme Leach suggested that potential GDP is being driven down close to zero. One immediate consequence is that fiscal sustainability is increasingly questionable. Again, this is something markets seem to be waking up to.

In the short term, inflation is under control. Headline CPI inflation is tracking back upwards, but is expected to reverse this trend and decline again over the next year. Weekly earnings growth is also tracking down. Given the low growth in the UK money supply, the probability of lower inflation is high. Absent a second Trump tariff war, he expects the bank to cut rates. Graeme Leach said that his recommendation is for a 50bps cut in the Base rate, given the lack of inflationary effect.

## Discussion

Tim Congdon said that on the US issue, the latest money growth figures are showing a rise. He said that there are two factors at work. First, Trump is easing up on the banks so that Basel 3 rules are having less of an effect. Another factor is the financing of the huge budget deficit, which is evident in the growth of money market mutual funds. He said that the economy's performance had confounded his forecast of a recession, and therefore, the message is that the US is very close to full employment. He said that inflation is more resilient in the US.

Patrick Minford said that the biggest problem is the uncertainty over tariffs. He said that there is a prospect of trade wars between the EU and the US, in addition to the one already underway between the US and China. A high tariff rate in the US will impact both the inflation rate and the political situation in the US. He said that the Big Beautiful Bill is going to be very unpopular. The change in public sentiment against Trump will alter his policies, and how that affects expectations is the joker in the pack. It is uncertainty piled on uncertainty. In the UK, the outlook is grim. He said that he agreed with the comments about productive potential. The government doesn't understand incentives, except to destroy them, so it is hard to feel anything but gloom. The only bright thing is the prospect for inflation, which is down and out. He said that he agrees with the assessment and that interest rates have to come down, and there needs to be a significant shift in Bank policy.

Andrew Lilico said that one of the most significant things in recent months has been the rise in long-dated gilt yields. This signals a fiscal easing, but suppose the Chancellor is unable to cut spending or raise revenue, and a fiscal crisis is on the horizon, what should happen to the interest rate now? If the government finds it difficult to rollover debt, what should happen to interest rates? Go up, go down, stay the same until the crisis occurs? One possible way out is for the government to raise the inflation target. Graeme Leach said that the best economic response was to start cutting government spending, but, politically, of course, that was not going to happen.

Kent Matthews said that in the event of a gilt strike and the government cannot roll over debt, and there is no sign of expenditure cuts, then the natural market reaction is to sell sterling and the exchange rate to slide. That has the effect of raising inflation anyway, which the government will have to validate through a de facto increase in the target. Patrick Minford said that it is more likely that taxes will be raised. This will weaken the economy, and interest rates will be lowered, resulting in long-dated rates falling. The downturn in the economy is expected to result in a recession, which will lead to lower inflation and interest rates. Andrew Lilico asked whether that means interest rates should be cut now? He said that Patrick's analysis suggests a rather severe recession scenario if this route is followed. Tim Congdon agreed that taxes will be raised, and that it will be a wealth tax, which raises problems about the migration of the tax base. However, it must be acknowledged that while taxes are higher than they have been in recent decades, UK taxes are not as high as those in some European countries, which manage to soldier on. He said that the best policy is to raise taxes by 4% of GDP and then cut spending drastically, thereby solving the problem. Once that is done, the interest rate problem is behind us, and we can concentrate on money growth.

Returning to the matter of the US money supply, John Greenwood noted that before the GFC, shadow bank assets/liabilities were larger than M2 or M3. After the GFC, bank assets continued to grow, albeit at a slower rate due to QE and bank recapitalisations, while shadow bank assets declined steeply. Since 2020, both banks and shadow bank assets have been growing strongly. The historical evidence is that shadow banks tend to reflect what is going on in the banking system. Shadow bank assets expand more in a monetary expansion and contract more in a monetary contraction. Now, shadow bank assets are growing strongly, but they are not separate from what is going on in the banking sector. US broad money is around 4½% and accelerating whereas shadow bank assets are growing at 11%. John Greenwood said that he, too, had forecasted a recession, but he stated that he had failed to fully understand the impact of the monetary overhang. The monetary easing in the Pandemic, resulting in the monetary overhang, was not fully offset by the subsequent monetary tightening. Regarding the UK, the government is fixated on the discredited notion that government spending can stimulate the economy. He said that he sees no prospect of this, given the constraint on money growth.

Roger Bootle said that he was very concerned with the fiscal situation. He said that looking at the debt dynamics, the debt interest payments are scary. He said that, given the current inflation rate, the Bank has scope to cut, which will affect the long rate, but this will also depend on what happens to the exchange rate. He said that the size of the state must be reduced. There is a potential fiscal crisis, but that may not occur in the immediate future,

which allows scope for interest rates to be lowered. For now, they will raise tax rates, and the lower interest rates will help the debt burden..

Trevor Williams said that one of the key points raised in Graeme Leach's presentation concerned the resilience of US growth. He said that one reason is that the US is self-sufficient in energy, which helps it to absorb energy shocks when other countries face higher energy prices. In the UK, high energy costs are one possible reason for low productivity. He said that there are levers that can help with productivity. Policies related to energy costs and infrastructure spending could help boost productivity in the longer term.

Graeme Leach expressed scepticism about the infrastructure argument. He said that infrastructure, such as HS2, takes a long time to build, and then it takes a decade for it to feed through to productivity. Andrew Lilico asked about the role of AI in boosting productivity. Graeme Leach said that he thought the size of the state sector would act as a drag. He said that the market sector has had a productivity increase of 21% in the past two decades, whereas the state sector has gone down 5%. Trevor Williams added that there have been two jumps in the size of the state sector. In 2008-9 and during the Pandemic. These were significant rises in the share of the state sector, and it is unclear whether these two structural shifts will persist.

Trevor Williams brought the discussion to a close and called for the others to cast their votes. He asked the guest economist in attendance, Mr Shamik Dhar, to make any observations. Shamik Dhar said that he found the discussion fascinating. He said that he was less sanguine about the world economy and UK inflationary prospects. He expressed concern about the stagflationary shocks arising from the tariff wars and worried about the ease of monetary conditions in the UK and the state of public debt. He said that the degree of real wage resistance in the labour market is another worry.

### **Votes.**

Votes are recorded in the order they were given.

### **Comment by Graeme Leach**

**(Macroeconomics)**

**Vote: To cut Base Rate by 50bps. Stop QT**

**Bias: No bias.**

Graeme Leach had made his view clear and his justification in the presentation and discussion.

### **Comment by Patrick Minford**

**(Cardiff Business School, Cardiff University)**

**Vote: To cut Base Rate by 50bps. Pause QT.**

**Bias: interest rates to fall further.**

Patrick Minford said that the prospects of a recession are worsening, and this is happening under a falling inflation rate. He said that he agreed with much of what Graeme Leach has already said and had nothing more to add.

### **Comment by John Greenwood**

**(International Monetary Monitor)**

**Vote: Cut Base Rate by 25bps. Pause QT.**

**Bias: No bias.**

John Greenwood expressed no strong view on interest rates. He said that a cut in the interest rate would be fine. He said that the important thing is to manage M4x growth roughly in the band of 3-5%. Provided money supply growth in this range is maintained, he would vote for a 25-bps cut. Furthermore, QT should be put on hold until credit growth is much stronger. Money growth is within the range so a cut is ok but if it moved beyond this range then a cut would not be appropriate.

### **Comment by Tim Congdon**

**(Institute of International Monetary Research, University of Buckingham)**

**Vote: To hold Base rate.**

**Bias: No Bias.**

Tim Congdon said he is very much like John in favour of watching money growth. He said that he is a bit more permissive, though and said that a range of 2 - 6% rather than 3 – 5% is acceptable, although trying to keep it at 3 - 4% is the ideal. He said that he is worried about the loss of financial market confidence, but given the budget position, he said that interest rates should be on hold. He is against cutting rates until there is greater clarity about market reaction and the credibility of the fiscal position. He said that he was relaxed about the world economy. US imports are only 3% of the world economy, and there is not going to be a recession in the US because of the strong money growth.

### **Comment by Roger Bootle**

**(Capital Economics)**

**Vote: Cut Base Rate by 25 bps.**

**Bias: No bias.**

Roger Bootle said that the justification is the weakening of the economy and that inflation is under control. The weakening of the labour market means that wage inflation is succumbing to all that, and the two will interact to produce some reasonable inflation numbers. He said that justifies a cut in rates, but not a ½% yet. He said that ¼ % cut would be right for now, and to wait and see.

### **Comment by Andrew Lilico**

**(Europe Economics)**

**Vote: Hold Base rate.**

**Bias: no bias**

Andrew Lilico said that monetary growth is in the acceptable region so there is no urgency to change interest rates at all. Short rates are much lower than long rates, so policy is if anything is accommodative. So, there is no strong reason for a cut. Economic growth is very weak, but he said that it is not clear that the weakening is not a supply side issue in which case he was not clear why demand side policy is used to address a supply driven problem. He said that if the economy goes into a recession that would be driven by a fiscal crisis. He votes to hold rates until there is greater clarity on the fiscal situation and the market reaction.

### **Comment by Kent Matthews**

**(Cardiff Business School, Cardiff University)**

**Vote: To cut Base Rate by 25bps. To pause QT.**

**Bias: No bias.**

Kent Matthews said that he agreed with Patrick Minford that uncertainty is piled on uncertainty, but that the uncertainty is not just about tariffs, it is also about no tariffs. This has had an effect on investment intentions and domestic demand. On top of this is the domestic uncertainty stemming from the fiscal situation. However, a sharp cut in the rate of interest might just precipitate the sort of financial crisis that was discussed. Hence it was time to be cautious rather than be bold. He thought that a modest cut in the rate was warranted and like others he said that he had no bias and would wait and see. On the issue of whether an interest rate cut is a demand side policy incorrectly targeted on a supply-side problem. He said there is a respectable body of theory that says that interest rates have a supply effect in a credit-constrained economy.

### **Comment by Trevor Williams**

**(University of Derby, TW Consultancy, and FXGuard)**

**Vote: Cut Base rate by 50 bps**

**Bias: To reach 3.00% with quarterly successive cuts and to continue QT**

Trevor Williams voted for a 50bps cut, emphasising the unfair burden on firms of paying interest that is significantly higher than the revenue they can generate, given the UK's weak economic growth. He believes that punitive costs of hiring, along with recent Budget measures, have already hit firms, as indicated by rising unemployment and falling profits. He also argues that QT should be retained, as QE is partly to blame for the



public sector financing mess, so reversing it is essential. Public sector financing must be brought under control. When it comes to the economy, Trevor Williams shares the view that the impact of tariffs on the UK economy will be moderate. He bases this on the relatively small size of the manufacturing sector, which accounts for only 7% of the economy's output measure. Thankfully, the large international trade surplus the UK has on services has so far not been an issue in the tariff debate. He also notes that a 1% underlying growth of the economy with a 2% inflation target implies a 3% nominal Bank rate. Therefore, he recommends adjusting rates to that level as soon as possible, starting with a 50bp cut at the next MPC meeting and one in the following quarterly one.

### **Comment by Julian Jessop (in absentia)**

**(Independent Economist)**

**Vote: Cut in Base Rate by 25 bps. Pause on QT.**

**Bias: No bias**

Julian Jessop said that his vote is to cut Bank rate by a  $\frac{1}{4}$  point, to 4%, with no bias thereafter. He said that inflation has been rising further above the 2% target, but this is unlikely to be sustained. The economy has stalled again, expectations for inflation are mostly stable, the labour market and wage growth are now cooling rapidly, and growth in broad money is easing from an already slow pace. A short-term interest rate of 4% could be seen as a 'neutral' level. He said that he would also pause QT pending a full review of the policy, including the appropriate interest rate to be paid on the excess reserves.

### **Any other business**

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

### **Policy response**

1. There was a majority agreement that monetary policy needed to be loosened.
2. A majority of the committee voted to cut Base rate. immediately.
3. Four members voted for a cut in Base rate by 25bps
4. Three members voted to cut Base rate by 50bps
5. Two members voted to hold Base rate.
6. By convention, the committee proposed a cut to Base rate of 25bps
7. A majority of the committee expressed no bias to further cuts, opting for a wait and see position, while two expressed a bias for further cuts

### **Date of next meeting**

14 October 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), Juan Castaneda (Vinson Centre, University of Buckingham).