



Interest Rates – January 2007

Background

Since being made independent the core remit of the Bank of England, as determined by the Chancellor, is to meet inflation targets. The secondary requirement is to maximise economic growth and employment. The argument being that a stable low inflation economy will provide the business environment to ensure the secondary requirements.

The Monetary Policy Committee (MPC) of the Bank of England will decide to increase interest rates in periods of economic growth when there is a danger of 'demand pull' inflation (when demand for goods & services is exceeding the supply, assuming the economy is at full capacity). Increases in interest rates, in these periods, will slow down consumer spending.

Current Situation

On the 11th January 2007 the MPC made the decision to increase interest rates to 5.25%. This comes only two months after the November rise from 4.75% to 5%.

Reaction

Amicus is concerned that the Bank of England is using short-term inflation expectations as the justification for a further rate hike. We believe that this latest increase was unnecessary, irrespective of what lagging inflation data may have shown. Further, we believe that the Bank should stand ready to cut rates in response to easing energy prices and declining global economic activity.

With a potential short term decline in consumption we should also consider the other cause of inflation. No doubt some economic commentators are concerned about the potential of inflation being caused by increasing wage demands (which themselves would be fuelled by the increase in RPI). We would question this motivation for an interest rate increase. A view shared by the CBI whose Chief Economist, Ian McCafferty, noted, "If part of the intention was to dampen wage increases, it is doubtful that a rate rise will have the desired effect".

Amicus believes that sufficient evidence exist to show that - the continuing stability of pay settlements in manufacturing means there are no wage inflationary pressures building up that should concern the MPC.

We are also extremely concerned about the detrimental effect this single policy of hiking interest rates is having on investment in the UK manufacturing base. It is not insignificant that manufacturing output has only risen by 0.1% in the 3 months to November 2006.