

Bank of England News Release of 8th October 2008

Bank of England Reduces Bank Rate by 0.5 Percentage Points to 4.5%

The Bank of England's Monetary Policy Committee today voted at a special meeting to reduce the official Bank Rate paid on commercial bank reserves to 4.5%.

The Monetary Policy Committee held a special meeting on Wednesday 8 October, some hours in advance of its normal schedule. After that meeting, the Bank of England, in conjunction with the Bank of Canada, the European Central Bank, the US Federal Reserve, Sveriges Riksbank, the Swiss National Bank and the Bank of Japan, released the following statement:

Throughout the current financial crisis, central banks have engaged in continuous close consultation and have cooperated in unprecedented joint actions such as the provision of liquidity to reduce strains in financial markets.

Inflationary pressures have started to moderate in a number of countries, partly reflecting a marked decline in energy and other commodity prices. Inflation expectations are diminishing and remain anchored to price stability. The recent intensification of the financial crisis has augmented the downside risks to growth and thus has diminished further the upside risks to price stability.

Some easing of global monetary conditions is therefore warranted. Accordingly, the Bank of Canada, the Bank of England, the European Central Bank, the Federal Reserve, Sveriges Riksbank, and the Swiss National Bank are today announcing reductions in policy interest rates. The Bank of Japan expresses its strong support of these policy actions.

In conjunction with the above statement, the Bank of England's Monetary Policy Committee released the following statement:

In the United Kingdom, CPI inflation rose to 4.7% in August, reflecting increases in food and energy prices. Inflation is likely to rise further to above 5% in the next month or two, in large part as the full effects of already announced increases in the price of domestic energy are felt. But inflation should then drop back, as the contribution from retail energy prices wanes and the margin of spare capacity in the economy increases. Pay growth has so far remained subdued and commodity price pressures have eased, with oil prices down substantially from their mid-summer peak.

Conditions in international credit and money markets have deteriorated very markedly. Many markets are closed. In the United Kingdom, the supply of credit to households and businesses is clearly tightening further as banks seek to adjust their balance sheets. The Committee noted that cuts in official interest rates could not be expected to resolve the current problems in financial markets and that a significant increase in the capital of the banking sector would be required. The Committee therefore welcomed this morning's announcement of a Government programme to recapitalise the major UK banks.

Data released over the past month indicate that the outlook for economic activity in the United Kingdom has deteriorated substantially, reflecting a sharp monetary contraction. Output growth slowed to a halt in the second quarter, business surveys point to further weakening during the second half of this year, and the labour market has softened. Consumer spending growth has slowed, in part as a result of the squeeze on real incomes, while business and dwellings investment have declined. Equity prices have fallen, and the further tightening in credit conditions will also weigh on domestic demand growth. The depreciation in sterling over

the past year should support net exports, but the prospects for demand growth in the UK's main export markets have worsened. The weakness in output growth at home will open up a growing margin of spare capacity that will over time bear down on inflation.

The Committee remains focussed on setting Bank Rate in order to meet the 2% inflation target. In doing so it continues to balance two risks. On the downside, there is a risk that a sharp slowdown in the economy, associated with weak real income growth and the tightening in the supply of credit, pulls inflation materially below the target. On the upside, there is a risk that above-target inflation this year and next raises inflation expectations so that inflation persists above the target for a sustained period. During the past month, the balance of those risks to inflation in the medium term has shifted decisively to the downside. In the light of that outlook, the Committee judged at its October meeting that an immediate reduction in Bank Rate of 0.5 percentage points to 4.5% was necessary to meet the 2% target for CPI inflation in the medium term.

The minutes of the meeting will be published at 9.30am on Wednesday 22 October.

Note to Editors

The previous change in Bank Rate was a reduction of 0.25 percentage points to 5.0% on 10 April 2008.