

How better monetary policy can help enhance economic stability

Policy briefing | April 2026

Executive summary

The UK just experienced its worst inflationary crisis in four decades, and may be entering another. Though the pace of price rises has fallen from its 2022 peak, inflation has remained above the Bank of England's 2% target for three years, and the war in Iran is expected to reverse the downward trajectory. The Bank's monetary policy framework has clearly failed to deliver price stability, yet has imposed severe costs in the attempt: high interest rates pushed hundreds of thousands into poverty through higher mortgage costs¹ with mortgage rates already starting to rise again in anticipation of further rate hikes.² Interest rate rises tend to worsen inequality,³ and the Bank's quantitative easing programme has deepened generational wealth divides by further enriching those already holding significant assets.⁴ The subsequent unwinding of this programme has passed billions in costs to the public purse.

Problems run deeper than the immediate crisis. Monetary policy has not been formally reviewed since 2013, despite a Treasury commitment to do so by the end of 2019.⁵ In the meantime, the challenges it faces have transformed: inflation is increasingly driven by supply shocks that interest rates are ill-suited to address, monetary policy decisions are severely reducing the fiscal space available to the government, and the Bank is making significant changes to how it operates with little democratic scrutiny.

The failure of our inflation-tackling toolkit is politically as well as economically destabilising. Around three-quarters of British people say that the country's general

¹ Cribb, J., Henry, A., Karjalainen, H., Ray-Chaudhuri, S., Waters, T. and Wernham, T. (2024). *Living Standards, Poverty and Inequality in the UK: 2024*. Institute for Fiscal Studies.

<https://ifs.org.uk/publications/living-standards-poverty-and-inequality-uk-2024>

² Moneyfacts (2026). Impact of Iran war on mortgages. Moneyfacts Compare.

<https://moneyfactscompare.co.uk/news/mortgages/impact-of-iran-war-on-mortgages/>

³ Positive Money (2023). 'Distributional effects of monetary policy'.

<https://positivemoney.org/eu/update/distributional-effects-of-monetary-policy/>

⁴ Pittaway, S. (2024). *Inequality Control: Why wealth inequality has not increased while asset prices have soared and what that means for the future*. Resolution Foundation.

<https://www.resolutionfoundation.org/publications/inequality-control/>

⁵ HM Treasury (2013). *Review of the Monetary Policy Framework*.

<https://www.gov.uk/government/publications/review-of-the-monetary-policy-framework>

economic condition will get worse over the next 12 months,⁶ and the cost of living is amongst the top 3 national priorities of 54% of people.⁷ With the Iran war now threatening a fresh wave of energy-driven price rises, public confidence in the government's ability to manage the cost of living, already at just 10%, is unlikely to recover without visible action.⁸ A monetary policy framework that is not fit for purpose is not a technocratic problem: it is a direct cause of the pressures people around the country feel every day.

The sections below set out what is going wrong, what a better framework could look like, and why acting now to set a monetary policy commission in motion matters.

1. Inflation dynamics are changing

Supply-side shocks are the new norm

Inflation dynamics are becoming more heavily driven by supply-side shocks than in previous decades.⁹ The outbreak of war in Iran in February is the latest example: wholesale gas prices surged by around 75% in the weeks following the first strikes, and the Bank of England's estimates CPI inflation will remain between 3% and 3.5% through much of 2026 - well above its 2% target and a significant reversal from the path back to target the Bank had projected just weeks earlier.¹⁰ The UK is particularly exposed to shocks of this kind: it is heavily reliant on imports of energy, food and other essential inputs, so global price shocks feed through quickly and broadly into domestic prices.¹¹

Analysis from central banks and international institutions, including the Bank for International Settlements¹² and the European Central Bank¹³ (ECB), highlight the increasing role of energy price shocks, global supply chain disruptions, labour market mismatches, and geopolitical fragmentation, in driving inflationary outcomes.

⁶ Ipsos (2026). 'Trends - Economy'. <https://www.ipsos.com/en-uk/uk-opinion-polls/trends-economy>

⁷ YouGov (2026). 'Britons and the cost of living, January 2026'.

<https://yougov.co.uk/politics/articles/53823-britons-and-the-cost-of-living-january-2026>

⁸ YouGov (2026). 'Few Britons believe any party sees cost of living as a top priority'.

<https://yougov.com/en-gb/articles/54427-few-britons-believe-any-party-sees-cost-of-living-as-a-top-priority>

⁹ Foundation for European Progressive Studies (2023). *The Profit-Price Spiral in Food and Energy*.

<https://feps-europe.eu/publication/the-profit-price-spiral-in-food-and-energy/>

¹⁰ Bank of England (2026). 'Bank Rate maintained at 3.75% — March 2026 Monetary Policy Summary and Minutes'.

<https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2026/march-2026>

¹¹ Dhingra, S. and Page, J. (2023). 'Accounting for imported and domestically generated inflation: supply chains, monetary policy, and the UK's cost of living crisis'. VoxEU/CEPR.

<https://cepr.org/voxeu/columns/accounting-imported-and-domestically-generated-inflation-supply-chains-monetary>

¹² Reis, R. (2022). 'The burst of high inflation in 2021–22: how and why did we get here?' *BIS Working Papers*, no. 1060. <https://www.bis.org/publ/work1060.htm>

¹³ Nickel, C. et al. (2023). 'A strategic view on the economic and inflation environment in the euro area'. *ECB Occasional Paper*, no. 371. <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op371.en.pdf>

These forces bring into question the suitability of using demand-management tools such as interest rates in response, especially given the trade-offs they entail.¹⁴ A recent International Monetary Fund (IMF) report shows that countries that raised interest rates more sharply after the 2022 inflation surge did not see better results in bringing inflation down.¹⁵ Not only is raising interest rates ill-suited to addressing supply-shocks, high rates also hold back investment and therefore growth,¹⁶ and raising interest rates worsen inequality.¹⁷ Crucially, high rates slow down investment that is urgently needed to increase our resilience to future shocks.¹⁸ Meanwhile, proposals for adapting monetary policy instruments that could help to alleviate these problems have not received sufficient consideration.

A new inflation-tackling toolkit is needed and should be publicly discussed

Responding to this changing landscape effectively requires better coordination between monetary and fiscal policy, and new monetary policy tools and frameworks that target structural drivers of inflation and increase economic resilience.

Targeted fiscal policy can be used to more effectively tackle inflation arising from supply shocks by acting at their source, mitigating excessive price rises in key sectors such as energy from propagating throughout the economy and thus reducing the burden on monetary policy. It can also be used to cushion impacts for the hardest-hit households. In response to recent inflation, France and Spain used energy and rent price caps, VAT cuts on essentials, transport subsidies, and demand-reduction policies (like making it easier to switch to public transport and heat pumps) to contain inflation more effectively than the UK while strengthening long-term resilience.¹⁹ In Germany, the Federal Cartel Office conducted an extensive sector inquiry into the refining and wholesale fuel markets²⁰ - examining pricing mechanisms and competitive conditions and highlighting transparency and competition risks that can influence price setting. German competition authorities have also scrutinised

¹⁴ Prieg, L., Mang, S., Caddick, D., Jourdan, S. and Harris, T. (2025). *How Do You Solve a Problem Like Inflation? The Case for Monetary-Fiscal Coordination*. New Economics Foundation.

<https://neweconomics.org/2025/03/how-do-you-solve-a-problem-like-inflation>

¹⁵ Imam, P.A. and Poghosyan, T. (2025). *Navigating the 2022 Inflation Surge: A Comparative Analysis of IT and Non-IT Central Banks*. IMF Working Paper WP/25/212. International Monetary Fund.

<https://www.imf.org/en/-/media/files/publications/wp/2025/english/wpiea2025212-source.pdf>

¹⁶ Bloom, N., Bunn, P., Mizen, P., Smietanka, P. and Thwaites, G. (2024). 'The impact of higher interest rates on UK firms'. VoxEU/CEPR.

<https://cepr.org/voxeu/columns/impact-higher-interest-rates-uk-firms>

¹⁷ Positive Money (2023). 'Distributional effects of monetary policy'.

<https://positivemoney.org/eu/update/distributional-effects-of-monetary-policy/>

¹⁸ Serebriakova, A., Polzin, F. and Sanders, M. (2023). 'Effects of Monetary Policy Rates on Energy Technologies: Implications for the European Green Transition'. EconStor Working Paper.

<https://www.econstor.eu/bitstream/10419/316394/1/MP%20and%20Energy%20Technology%20Econstor%20working%20paper.pdf>

¹⁹ New Economics Foundation (2024). 'There are other ways to tackle the cost of living crisis — just ask France and Spain'.

<https://neweconomics.org/2024/01/there-are-other-ways-to-tackle-the-cost-of-living-crisis-just-ask-france-and-spain>

²⁰ Reed Smith LLP (2025). 'German Federal Cartel Office targets fuel refining and wholesale sector'.

<https://www.reedsmith.com/articles/german-federal-cartel-office-fuel-wholesale-sector>

competition within food supply chains and made recommendations to address concerns of market concentration.²¹

The UK Government has shown steps towards better monetary-fiscal coordination. The energy bill measures introduced in the 2025 Autumn budget were explicitly intended to address headline inflation, which is reflected in the Bank of England's analysis.²² However, the role of fiscal, regulatory and industrial policy tools in dampening prices should be more formally embedded and proactively drawn upon within the UK's inflation-tackling toolkit, for example through the creation of an Economic Coordination Council.²³

On the monetary policy side, the Bank should be enabled to adapt its approach when inflation is driven by supply-side shocks - such as by viewing its inflation target over a longer-term time horizon than the current 2-years, and by using additional instruments available to it to increase supply side resilience.²⁴ Such instruments could look like the Bank following the ECB and green its collateral framework, meaning adjusting the assets accepted and the terms applied to lending in the Bank's regular lending facilities, to reduce the existing bias toward high-emission industries and lower financing costs for sustainable sectors.²⁵ This would contribute to mitigating fossil fuel-driven and climate-driven supply constraints that feed into price levels. The Bank is increasingly providing liquidity through these facilities, meaning that this presents a salient opportunity to channel financing towards price-stabilising activities.²⁶ Secondly, the Bank could build on the success of the COVID-19 era Term Funding Scheme for Small and Medium Sized Enterprises, and offer a targeted lending scheme that offers lower borrowing costs for investments aligned with government priorities, such as the green transition and the industrial/infrastructure strategies.²⁷

²¹ Monopolkommission. (2025) *Special Report 84: Competition in the Food Supply Chain*.

<https://www.monopolkommission.de/en/reports/special-reports/special-reports-on-own-initiative/486-special-report-84-competition-in-the-food-supply-chain>

²² Bank of England (2026). *Monetary Policy Report, February 2026*.

<https://www.bankofengland.co.uk/monetary-policy-report/2026/february-2026>

²³ Prieg, L., Mang, S., Caddick, D., Jourdan, S. and Harris, T. (2025). *How Do You Solve a Problem Like Inflation? The Case for Monetary-Fiscal Coordination*. New Economics Foundation.

<https://neweconomics.org/2025/03/how-do-you-solve-a-problem-like-inflation>

²⁴ Cetex (2024). *The Case for Adaptive Inflation Targeting: Monetary Policy in a Hot and Volatile World*.

<https://cetex.org/publications/the-case-for-adaptive-inflation-targeting-monetary-policy-in-a-hot-and-volatile-world/>

²⁵ Harris, T. (2025). 'As Europe burns, can the ECB turn words into action on green policy?' New Economics Foundation.

<https://neweconomics.org/2025/07/as-europe-burns-can-the-ecb-turn-words-into-action-on-green-policy>

²⁶ Youel, S. (2026). *Taking All the Credit: Future-proofing Money and Credit Policy for the 21st Century*. Positive Money.

<https://positivemoney.org/uk/publications/taking-all-the-credit-future-proofing-money-and-credit-policy-for-the-21st-century/>

²⁷ Harris, T. (2024). *Reducing Interest Rates for Clean Energy Investments*. New Economics Foundation.

<https://neweconomics.org/2024/12/reducing-interest-rates-for-clean-energy-investments>

2. Monetary policy is unnecessarily reducing fiscal space

The Bank of England's monetary policy decisions, and the way in which the Bank's Quantitative Easing (QE) scheme was designed in 2009, are exerting fiscal pressure on the chancellor, and are internationally unusual.

In the wake of the pandemic, the Bank of England began unwinding its QE programme - gradually offloading the government bonds it had accumulated, in a process called quantitative tightening (QT). Unlike most other central banks, the Bank has chosen to actively sell assets into the market, rather than holding them to maturity. Because interest rates have risen sharply since the bonds were purchased, this means it is selling them at a large loss.²⁸ Secondly, the design of the QE scheme in 2009 requires that these losses be indemnified by the Treasury, rather than kept on the Bank's balance sheet (as is the case for the US Fed and the ECB), resulting in the fiscal costs being incurred immediately.

These dynamics also mean that while the state has to deal with more expensive public finances and households struggle with a cost of living crisis, the banking sector is receiving tens of billions in interest payments on reserves they hold with the Bank.²⁹ This is far more than we need to pay for monetary policy to work, and there are multiple ways in which the Bank could reduce these costs. Retaining losses on its balance sheet (as is done by the ECB and US Fed) could potentially free up £4.8bn a year in day-to-day spending under the fiscal rules.³⁰ Such changes would require the Treasury amending the indemnity agreement, which should be negotiated with the Bank in order to preserve its independence. Alternatively (or in addition), the Treasury could introduce a system of tiered reserves to reduce payments to banks, which is estimated to save £1.3bn a year following the ECB's model,³¹ or a windfall tax on bank profits, which could have recouped £12.5bn for 2025 if following the Spanish Government's model.³²

²⁸ Mahon, Christopher. (2025). When active QT makes sense. Financial Times.

<https://www.ft.com/content/f86abe99-195f-48a0-98ad-686b78ef91f3>

²⁹ Caddick, D. (2025). 'The Bank of England is costing us billions'.

<https://neweconomics.org/2025/02/the-bank-of-england-is-costing-us-billions>

³⁰ Caddick, D. and Bull, I. (2025). *Rewriting the indemnity*. New Economics Foundation.

<https://neweconomics.org/2025/11/rewriting-the-indemnity>

³¹ Caddick, D. (2023). *Government could save £55bn over the next five years by limiting Bank of England's interest payments to commercial banks*. New Economics Foundation.

<https://neweconomics.org/2023/11/government-could-save-55bn-over-next-five-years-by-limiting-bank-of-englands-interest-payments-to-commercial-banks>

³² Positive Money (2026). The Chancellor's missing billions: windfall tax on banks could've raised £12.5bn.

<https://positivemoney.org/uk/press-release/the-chancellors-missing-billions-windfall-tax-on-banks-couldve-raised-pound125bn/>

3. Monetary policy is evolving without scrutiny

The Bank's framework is changing, with impacts for monetary policy and the wider economy

During QE, the Bank created new money (reserves) to buy government bonds, flooding the banking system. This meant commercial banks always had plenty of funds to settle daily transactions with each other, and the Bank simply paid interest on those reserves to implement monetary policy. Now, as QT drains those reserves away, banks are increasingly having to borrow from the Bank of England to meet their needs. This means the terms on which the Bank lends, and crucially the collateral it accepts, will play an increasingly influential role in shaping the financing conditions faced by commercial banks, and in turn this will be transmitted to businesses across the real economy. This is termed a 'repo-led operating framework'.³³

While the move to a repo system is a normal consequence of unwinding QE, it is important to note that when the Bank conducts repos (lending transactions with commercial banks), it has to decide what it will accept as collateral, and that decision is not neutral. Assets made eligible effectively receive a premium - because they can be more easily exchanged for central bank reserves, they are seen as more valuable by the banking system. Financial markets use the collateral frameworks of major central banks' as a basis for their own collateral-based lending, which is a major way in which banks fund their activities. As a result, assets accepted as collateral by the central bank, and on more favourable terms, are in greater demand by banks and investors, and have been found to benefit from higher asset prices and lower yields, meaning that their issuers - such as governments or corporations - are able to raise financing more cheaply.

This means collateral eligibility criteria guides flows of credit - the Bank is implicitly picking which sectors and instruments benefit from its liquidity support. Under the repo framework this impact becomes even greater, because banks rely more heavily on the central bank (rather than trading between each other) for reserves.. This shift therefore warrants democratic scrutiny, as it is monetary policy, but it is also quietly industrial policy.

However, public engagement on this substantial change to monetary policy has been limited to technical discussion papers aimed at financial market participants, and lacked democratic deliberation of the implications for the real economy. A recent report from Positive Money sets out alternative approaches to the Bank's collateral framework, arguing that these decisions should be subject to greater democratic scrutiny and directed towards productive investment in the real economy.³⁴

³³ Bank of England (2024). *Discussion Paper: Transitioning to a repo-led operating framework*, available at: <https://www.bankofengland.co.uk/paper/2024/dp/transitioning-to-a-repo-led-operating-framework>

³⁴ Youel, S. (2026). *Taking All the Credit: Future-proofing Money and Credit Policy for the 21st Century*. Positive Money. <https://positivemoney.org/uk/publications/taking-all-the-credit-future-proofing-money-and-credit-policy-for-the-21st-centur/>

Decisions are being made over who gets access to the Bank's liquidity backstop

The Bank of England has in recent years expanded its liquidity facilities to institutions beyond the traditional banking sector, in response to episodes of market stress. Formerly focused on banks, these facilities were temporarily extended to non-bank financial institutions following the September 2022 "mini-budget".³⁵

The Bank has since opened a new, permanent facility to provide liquidity to non-banks in future instances, reflecting the need to stabilise a growing non-bank financial sector.³⁶ This represents a notable evolution in the Bank's approach, providing a new public backstop to a wider array of non-bank financial institutions at a time when their size, and the risks they pose to financial stability, are growing.³⁷ Whilst potentially positive for short-term financial stability, providing a public backstop to a wider array of financial institutions may create moral hazard problems down the line. When financial institutions know that a public backstop exists, they have less incentive to manage their own liquidity risk prudently. The implicit guarantee encourages the very risk-taking that makes future crises more likely. This problem is compounded by the fact that non-bank financial institutions are subject to lighter regulation than banks, meaning the public is underwriting institutions that face fewer constraints on their behaviour.

The Bank's decisions about who receives liquidity, on what terms, and against what collateral have real distributional consequences, shaping which parts of the economy can access finance and on what basis. These are fundamentally political choices about the use of public resources, yet they have been made largely through technical consultation processes directed at financial industry participants, with little opportunity for broader democratic deliberation. Parliament has not been asked to express a view on which institutions should benefit from public liquidity support, nor on what conditions should apply.³⁸

4. Scrutiny of monetary policy is long overdue

The issues outlined above cannot be separated from broader questions surrounding the appropriate role for elected officials in monetary policymaking. Internationally, aggressive rate hikes in response to recent inflation has seen central bank independence come under direct threat from populist political leaders. In the UK, the perception that monetary policy

³⁵ Bank of England (2025). 'Enhancing the resilience of the gilt repo market: discussion paper'. <https://www.bankofengland.co.uk/paper/2025/discussion-paper/enhancing-the-resilience-of-the-gilt-repo-market>

³⁶ Bank of England (2025). 'Contingent NBFi Repo Facility (CNRF)'. <https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/cnrf>

³⁷ House of Lords Financial Services Regulation Committee (2025). 'Financial Services Regulation Committee publishes private markets report'. <https://committees.parliament.uk/committee/697/financial-services-regulation-committee/news/211242/financial-services-regulation-committee-publishes-private-markets-report/>

³⁸ Youel, S. (2026). *Taking All the Credit: Future-proofing Money and Credit Policy for the 21st Century*. Positive Money. <https://positivemoney.org/uk/publications/taking-all-the-credit-future-proofing-money-and-credit-policy-for-the-21st-centur/>

has worsened the cost-of-living crisis, hindered much-needed investment, and impacts on fiscal policy heightened these risks. The stark fiscal costs imposed by the Bank of England's interventions have already come under attack from across the political spectrum, dynamics that have arguably been exacerbated by an absence of sufficient public scrutiny.

The Treasury last reviewed the UK's monetary policy framework in 2013. Prior to this, it changed the Monetary Policy Committee's (MPC) inflation target to 2% in 2003, and before then gave the MPC operational independence over monetary policy in 1997.

More comprehensive, independent assessments of monetary policy and the financial system were carried out earlier in the 20th century, including the 1959 Radcliffe Report and the 1931 Macmillan Report. In its 2013 review, the Treasury stated that, *"To ensure the UK's monetary policy framework remains at the forefront of international best practice, the Government will undertake a further review before the end of 2019."* However, no such review has yet taken place.

The Bank is a statutory corporation with a unique constitutional status, which is only subject to ad hoc reviews. Yet periodic external review is standard practice for UK arm's-length institutions. The Budget Responsibility and National Audit Act 2011 requires the Office for Budget Responsibility's non-executives to commission an external review every five years into the content and quality of its work. The government's 2020 Tailored Reviews guidance recommends that Arm's Length Bodies (ALBs) undergo review every 5 years, although the most recent Cabinet Office guidance emphasises proportionality to ensure the government invests scarce resources in reviews that will deliver impactful change for the citizen.

Comparison may also be made to the BBC - which arguably has a similar level of independence to the Bank of England - which has its charter reviewed every 10 years.

Certainly, at 13 years and counting, UK citizens are long overdue some democratic input.

Finally, periodic reviews of monetary policy frameworks have clear international precedent: New Zealand legislated a government-led review process in 2017, Australia's Treasurer commissioned an independent review in 2022 that has since led to a five-yearly review commitment, and Canada operates a five-yearly joint Bank-Government renewal process.

5. Meeting the scale of the challenge: the case for a Monetary Policy Commission

Monetary policy has far-reaching impacts on households and businesses across the UK, and the country also faces significant economic challenges. For these reasons, we propose the appointment of an independent Monetary Policy Commission, equipped with sufficient expertise and resources, the Commission would evaluate a wide range of evidence and report its findings and recommendations to the Government, Parliament, and the public.

The 1959 Radcliffe Report and the 1931 Macmillan Report - both major government-initiated inquiries into the workings of the financial and monetary system - are examples that can be followed.³⁹ The Macmillan Report, produced during the Great Depression, examined

³⁹ Youel, S. (2026). *Taking All the Credit: Future-proofing Money and Credit Policy for the 21st Century*. Positive Money.

banking, industrial finance, the Gold Standard, and the relationship between finance and industry - famously identifying the “Macmillan Gap” that describes the persistent failure of the financial system to lend to small and medium-sized firms. The Radcliffe Report, published in the post-war period, reviewed the entire monetary system, analysing credit creation, liquidity, interest rates, capital flows, and monetary policy’s effectiveness. Both took a broad, system-wide approach, providing policymakers with a deep institutional and theoretical understanding of how Britain’s financial system functioned and strengthening the basis for long-term economic reform.

A review on a similar scale currently is warranted. For MPs, the stakes are clear: the current framework is costing the public purse billions in unnecessary transfers to banks, leaving households exposed to inflation the Bank cannot control, and evolving in significant ways that have received little to no democratic scrutiny. A Monetary Policy Commission would equip parliamentarians to democratically scrutinise and engage with monetary policy, to ensure that the next iteration of the UK’s monetary framework is fit for the future.

A commission of this kind could be more or less extensive depending on its scope, but a timeline of 12-18 months is reasonable for an initial report. Though it is worth noting that both the Macmillan Committee and the Radcliffe Committee took closer to two years, reflecting the depth and breadth of inquiry. A commission should be led by an independent commissioner, with recommendations presented to both Houses of Parliament for debate. The Government and Bank of England should be required to respond formally, ensuring the exercise produces meaningful direction. Timelines for implementing recommendations will depend on the changes needed - many may be achievable within the Bank’s current mandate and institutional setup, while others may require changes to legislation and establishing new institutional arrangements, which may take longer to deliver.

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