

ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF

A1 This Annex summarises the analysis presented by Bank staff to the Monetary Policy Committee on 1 April 2005, in advance of its meeting on 6-7 April. At the start of the Committee meeting itself, members were made aware of the information that had subsequently become available, and that information is included in this Annex.

I Financial markets

A2 Since the Committee's previous meeting, short-term interest rates had fallen in the United Kingdom and the euro area but had risen in the United States. Interest rates implied by the December 2005 short-sterling futures contract had fallen by around 20 basis points, with weaker-than-expected data releases, including the *CBI Distributive Trades Survey* and the Nationwide house price index, contributing to the decline. Implied rates from US dollar futures for December 2005 had risen by 6 basis points, partly in response to the Federal Open Market Committee (FOMC) statement on 22 March. All but one of the economists surveyed by Reuters had expected rates to remain unchanged at the April MPC meeting, and the mean of economists' expectations for policy rates at the end of 2005 was unchanged, at 4.85%.

A3 Since the Committee's previous meeting, medium to long-term nominal forward interest rates implied by government bonds had fallen internationally. In the United Kingdom, ten-year forward rates had fallen by 9 basis points, while equivalent United States and euro-area forward rates had fallen by 6 basis points and 17 basis points respectively. As such, those falls had partly reversed the significant rises in medium to long-term forward rates seen between the Committee's February and March meetings. In the United Kingdom, euro area and United States, the declines in longer-term rates since the Committee's previous meeting reflected lower real forward interest rates, with implied inflation rates little changed. Short-term surveys of UK inflation expectations had also remained broadly unchanged and were still below, but close to, the inflation target. By contrast, in the United States the falls in longer-term rates had been almost wholly accounted for by declines in implied inflation rates.

A4 Exchange rate developments over the month had been dominated by movements in the US dollar. The US dollar effective exchange rate (ERI) had appreciated by 3.3%, related in part to an

increase in US interest rate expectations, particularly following the FOMC meeting on 22 March and US CPI data on 23 March. The sterling ERI had risen by 1.0% to 104.0 since the Committee's previous meeting. Sterling had appreciated by 1.6% against the euro and 2.2% against the yen, but had depreciated by 2.3% against the dollar. The euro ERI had depreciated by 1.4%, possibly reflecting news that EU finance ministers had agreed to relax the stability and growth pact. Over the month, exchange rate uncertainty implied by options prices had remained low for the major currency pairs.

A5 In local currency terms, the FTSE All-Share, S&P 500 and Topix price indices had decreased by 1.0%, 1.9% and 0.4% respectively, while the DJ Eurostoxx had remained almost unchanged. Options-based implied volatility measures had suggested uncertainty about the future value of the FTSE 100 was little changed. International investment-grade credit spreads had increased; much of the rise had followed the profit warning issued by General Motors on 16 March. Spreads for lower-quality corporate debt and emerging market sovereign spreads had also increased.

II The international environment

A6 According to the second estimate, French GDP had increased by 0.9% in 2004 Q4, revised up from growth of 0.8% in the previous release. The estimated contributions of net trade and investment to Q4 GDP growth had been revised up, while the contributions to GDP growth from consumption, government consumption and stocks had remained unchanged from the first release. Italian GDP had contracted by 0.4% in 2004 Q4, revised down from a fall of 0.3% in the flash estimate. Fixed investment had contracted by 1.7% on the quarter, while consumption and government expenditure had both increased by 0.2%. Exports had fallen by 4.7%, while imports had increased by 0.1%.

A7 Euro-area retail sales had increased by 0.3% in February compared with the previous month, following growth of 0.3% in January. The European Commission's consumer confidence indicator for the euro area had fallen to -14 in March, compared with -13 in February. The euro-area seasonally adjusted unemployment rate had increased to 8.9% in February, from 8.8% in January.

A8 Industrial production in the euro area had increased by 0.5% on the month in January, as it had in December. The European Commission's industrial confidence indicator for the euro area had fallen to -8 in March, from -6 in February. The euro-area purchasing managers' index (PMI) for manufacturing had fallen to 50.4 in March, from 51.9 in February. The euro-area PMI index for

services had remained at 53.0 in March. The German IFO index had fallen to 94.0 in March, from 95.4 in February.

A9 The Eurostat flash estimate for annual euro-area inflation, as measured by the harmonised index of consumer prices (HICP), had remained at 2.1% in March, unchanged from February. Producer price inflation (excluding construction) had been 4.2% in the year to February, compared with 3.9% in the year to January.

A10 According to the final estimate, US GDP had risen by 0.9% in 2004 Q4, unrevised from the preliminary estimate. Within this, the estimate for consumption growth had been unrevised at 1.0% on the quarter. Government spending growth had been revised down to 0.2%, from 0.3% previously. Private fixed investment growth had been revised up to 2.5%, from 2.3% in the preliminary release. Export growth had been revised up to 0.8%, from 0.6%, and import growth had remained unrevised at 2.7%. The US current account deficit had increased to 6.3% of GDP in 2004 Q4, from 5.6% in the previous quarter. Goods export volumes had fallen by 0.6% on the month in January, following growth of 4.0% in December; goods import volumes had grown by 2.1% in January, compared with zero growth in December.

A11 US non-farm payrolls had risen by 110,000 in March, following a downwardly revised increase of 243,000 in February. The unemployment rate had fallen to 5.2% in March, from 5.4% in February. Real private consumption in the United States had increased by 0.3% in February, compared with a fall of 0.1% in January. The saving rate had fallen to 0.6% of disposable income in February, from 0.8% in January. The Conference Board measure of consumer confidence had fallen to 102.4 in March, from 104.4 in February. The University of Michigan measure of consumer confidence had fallen to 92.6 in March, from 94.1 in February.

A12 US industrial production had risen by 0.3% in February compared with the previous month, following an upwardly revised increase of 0.1% in January. The Institute for Supply Management (ISM) manufacturing index had fallen to 55.2 in March, from 55.3 in February. The ISM non-manufacturing business activity index had risen to 63.1 in March, from 59.8 in February.

A13 US producer prices for finished goods had increased by 4.7% in the year to February, compared with a 4.2% rise in the year to January. The US headline consumer price index (CPI) had risen by

3.0% in the year to February, as it had in January. The annual inflation rate of the core CPI, which excludes food and energy prices, had been 2.4% in February, compared with 2.3% in January.

A14 According to the second estimate, Japanese real GDP had risen by 0.1% in 2004 Q4, compared with a downwardly revised fall of 0.3% in 2004 Q3. Within the total, private consumption had fallen by 0.3%, business investment had increased by 0.1% and government consumption had risen by 0.8% on the quarter. Net trade had contributed –0.1 percentage points to quarterly GDP growth.

A15 In Japan, industrial production had fallen by 2.1% on the month in February, after rising by 2.5% in January. The all-activity index had risen by 2.4% in January, compared with the previous month. According to the Bank of Japan's Tankan survey for March, the large manufacturers' business conditions diffusion index had fallen by 8 points, to 14, while the large non-manufacturers' business conditions diffusion index had remained unchanged, at 11.

A16 In China, industrial production growth had fallen to 7.6% in the year to February, following an increase of 20.9% in the year to January, at least in part reflecting distortions due to the timing of the Chinese New Year. Annual consumer price inflation had been 3.9% in February, compared with 1.9% in January.

A17 Since the Committee's previous meeting, the spot price of Brent crude oil had risen by \$0.48 to \$54.50 per barrel, an increase of 0.9%. Over the same period, the sterling spot price of Brent crude oil had risen by 3.3%, to £29.03 per barrel. Since the Committee's previous meeting, the price of the June 2006 Brent crude oil futures contract had risen by 11.6%, to \$54.51. *The Economist* dollar non-oil commodity price index had fallen by 1.4% over the same period.

III Demand and output

A18 Estimated GDP growth had been unrevised at 0.7% in 2004 Q4, at both constant market and basic prices, in the Quarterly National Accounts. Revisions in the latest release had affected GDP components back to 2003 Q1. The level of GDP had been largely unrevised, although within that there had been offsetting revisions, mentioned below.

A19 On the output side of the accounts, the service sector had been estimated to have grown by 0.9% in 2004 Q4, unrevised from the previous release. Consistent with the January Index of Production

release, manufacturing output had been estimated to have grown by 0.3% in Q4, revised up from 0.2% in the previous GDP release.

A20 On the expenditure side of the accounts, the estimated quarterly growth of final domestic demand had been revised down by 0.2 percentage points to 0.5% in 2004 Q4. Within that, households' consumption (including that of non-profit-making institutions serving households) growth had been revised down by 0.1 percentage points to 0.3%. But upward revisions to consumption growth in Q1 and Q3 had left the level of consumption 0.2% higher than previously estimated. Whole-economy investment growth had been revised down by 0.8 percentage points to 0.8% in Q4, which had mainly reflected a downward revision of business investment growth to 0.2%. Government consumption growth had been estimated at 0.9% in Q4.

A21 The contribution of inventories to GDP growth had been revised up in 2004 Q4 to 0.4 percentage points, from 0.1 percentage points in the previous release, largely reflecting revisions to the alignment adjustment. Domestic demand had been estimated to have grown by 0.9% in Q4, revised up from 0.8% in the previous release.

A22 Excluding the impact of Missing Trader Intra-Community (MTIC) fraud, estimated export and import growth had been 1.6% and 2.1% respectively in 2004 Q4. Net trade had been estimated to have made a contribution of -0.2 percentage points to GDP growth in Q4. Excluding fraud, the level of imports had been revised up by 0.3% by Q4, while the level of exports had been revised down by 0.5%.

A23 On the income side of the accounts, the headline ONS measure of households' real disposable income had been estimated to have fallen by 0.5% in 2004 Q4, but a broader measure of households' real post-tax income, based on total available households' resources, rose by 0.3% in Q4. Because household consumption had grown in line with (the broader measure of) household income, the saving ratio was little changed, at 5.8%.

A24 The gross operating surplus of corporations (excluding the alignment adjustment) had been estimated to have risen by 2.3% in 2004 Q4, following a fall of 2.5% in Q3, largely reflecting volatility in the profits of financial corporations. The gross trading profits of private non-oil non-financial corporations had been estimated to have risen by 0.8% in Q4, following a rise of 0.5% in Q3.

A25 Turning to indicators of output in 2005 Q1, the Index of Production release showed that manufacturing output had fallen by 0.5% in February, following unchanged output in January. Energy output had risen in February, following a sharp fall in January. So overall industrial production had been estimated to have fallen by 0.4% in February, after a 0.3% fall in January. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey output index had risen marginally to 53.1 in March, from 53.0 in February, while the new orders index had fallen back by 0.3 points on the month, to 52.6. The expected manufacturing output balance in the *CBI Monthly Trends Enquiry* had fallen to +9 in March, from +19 in February. The *CIPS Report on Services* business activity index had risen by 1.9 points in March, to 57.0, a change mirrored by the incoming new business index.

A26 Turning to indicators of expenditure in 2005 Q1, retail sales had grown by 0.2% in February, following a rise of 0.7% in January. The three-month on three-month growth rate of retail sales had fallen to -0.6% in February, from -0.2% in January. In the *CBI Distributive Trades Survey*, the balance of retailers reporting positive annual growth in sales volumes had fallen to -9 in March, from +2 in February. The GfK consumer confidence balance had increased to +0.7 in March, from +0.4 in February. According to the Society of Motor Manufacturers and Traders, new private car registrations had been 14.4% lower in the three months to March compared with a year earlier.

A27 Both goods export and goods import volumes had been estimated to have fallen in January (by 2.6% and 1.3% respectively), following rises in December.

IV Supply

A28 The annual growth rate of whole-economy labour productivity measured using numbers employed had been 1.7% in 2004 Q4, compared with 2.2% in 2004 Q3. The annual growth rate of whole-economy labour productivity measured using hours worked had been 1.0% in 2004 Q4, compared with 2.9% in 2004 Q3.

A29 Survey balances for capacity utilisation had been mixed. In the manufacturing sector, the British Chambers of Commerce (BCC) and the *CBI Quarterly Industrial Trends* survey balances for capacity utilisation had fallen slightly in 2004 Q4 compared with 2004 Q3. In the service sector, the BCC

survey balance measure had increased in 2004 Q4 compared with 2004 Q3. Both the BCC and CBI survey balances had been above their long-run averages. Whole-economy unit wage costs had increased by 2.0% in 2004 Q4 compared with the same period a year earlier.

A30 The Bank's regional Agents had conducted an informal survey of around 250 firms with over 300,000 employees on the prospects for labour productivity growth. Weighted by employment numbers, the balance of firms reporting that their labour productivity had been higher over the previous twelve months had been +41%. Manufacturers had reported particularly high productivity growth. The change in turnover or output had been cited as the most significant factor behind that productivity growth. A large proportion of firms had cited efficiency gains, often in response to the need to maintain or increase margins in the face of rising costs or increased competition.

A31 Although the balance of firms reporting that they expected labour productivity to increase over the next twelve months had been slightly higher, at +50%, fewer firms had expected productivity to be substantially greater in the next twelve months, so that overall there might be a slight slowing in the pace of productivity growth in the year ahead. The expected change in turnover or output had been cited as the most significant factor explaining expected increases in productivity in the next twelve months, followed closely by efficiency gains. Firms citing efficiency gains had suggested that there were still many opportunities to increase their efficiency, without significant capital spending.

V Costs and prices

A32 According to the Labour Force Survey (LFS), employment had increased by 127,000 in the three months to January compared with the three months to October. In the three months to January, the 16+ employment rate had risen by 0.2 percentage points, to 60.2%, compared with the three months to October and had increased by 0.1 percentage points compared with the same three-month period a year earlier. Average weekly hours worked had risen by 0.7% in the three months to January compared with the previous non-overlapping quarter, to 32.3.

A33 Survey balances on employment had generally risen slightly. For example, the overall CIPS employment survey balance for March had risen to 52.0. Within this, the services and manufacturing balances had risen and the construction balance had fallen.

A34 LFS unemployment had increased by 22,000 in the three months to January, but had been 31,000 lower than a year earlier. The LFS unemployment rate had been 4.7% in the three months to January, 0.1 percentage points lower compared with the same period a year earlier. The claimant count unemployment rate had been unchanged at 2.7% in February. The level of inactivity among those aged 16+ had decreased by 76,000 in the three months to January. The 16+ inactivity rate had fallen to 36.9% in the three months to January, down by 0.2 percentage points compared with the previous non-overlapping quarter, and had been unchanged compared with the same period a year earlier.

A35 According to settlements information available to the Bank, the mean whole-economy twelve-month average earnings index (AEI-weighted) settlement had remained at 3.2% in the year to February. The twelve-month mean settlement in the private sector (AEI-weighted) had been 3.3% and in the public sector (sample-weighted) had been 2.8%.

A36 Overall whole-economy annual earnings growth had been 4.4% in the three months to January, unchanged on the three months to December. In the three months to January, the annual growth rate of private sector pay had increased by 0.1 percentage points, to 4.4%, and the annual growth rate of public sector pay had fallen by 0.1 percentage points, to 4.6%. Whole-economy earnings growth in the year to January had fallen by 0.1 percentage points, to 4.2%. Whole-economy annual earnings growth excluding bonuses had been unchanged at 4.4% in the three months to January compared with the three months to December.

A37 UK manufacturing input prices had risen by 0.1% in February. The annual inflation rate had risen to 10.8% in February, from a revised 9.6% in January. The *CIPS Report on Manufacturing* input price balance had fallen to 63.9 in March, from 65.9 in February.

A38 Manufacturing output prices excluding duties (PPIY) had risen by 0.5% in February. The annual PPIY inflation rate had risen to 3.0% in February, from 2.7% in January. The balance on expected output prices from the *CBI Monthly Trends Enquiry* had fallen to +9 in March, from +11 in February.

A39 According to the ONS's Quarterly National Accounts release, the annual inflation rate of the GDP deflator at market prices had risen to 2.1% in Q4, from 1.8% in Q3. The annual inflation rate of the household consumption deflator had fallen to 1.0% in Q4, from 1.2% in Q3. The annual inflation

rate of the government consumption deflator had risen to 3.1% in Q4, from 2.9% in Q3. The annual inflation rates of the imports and exports deflators had been 0.1% and 1.5% respectively in Q4.

A40 Annual CPI inflation had been unchanged at 1.6% in February. Within this, annual goods price inflation had been unchanged at -0.2%, and annual services price inflation had been unchanged at 3.8%. Annual RPIX inflation had remained at 2.1% in February. Annual RPI inflation had been unchanged at 3.2% in February.

VI Money, credit and nominal trends

A41 The twelve-month growth rate of notes and coin, adjusted for special factors, had fallen to 5.2% in March, from 5.9% in February. The three-month annualised growth rate had remained at 5.7% in March. The annual growth rate of aggregate M4 deposits had increased to 9.5% in February, from 9.3% in January. The annual growth rate of M4 lending (excluding the effects of securitisations) had increased to 12.8% in February, from 12.5% in January. Excluding other financial corporations, annual M4 deposit growth had fallen to 8.5% in February, from 8.8% in January, while annual M4 lending growth (excluding the effects of securitisations) had fallen to 11.0%, from 11.3% in January.

A42 The annual growth rate of households' M4 had risen by 0.1 percentage points, to 8.6% in February. The annual growth rate of total net lending to individuals, a wider measure than M4 lending that includes lending by a broader set of institutions than just banks and building societies, had decreased by 0.4 percentage points, to 12.4%, in February. The annual growth rate of secured lending to individuals had decreased to 12.1% in February, from 12.5% in January, while the annual growth rate of unsecured lending to individuals had decreased to 13.8% in February, from 14.2% in January. Within unsecured lending, the annual growth rate of credit card lending had increased by 0.1 percentage points, to 22.3%, in February, while the annual growth rate of other unsecured lending had decreased to 10.5% in February, from 11.1% in January.

A43 At 6.60%, the average standard variable rate on mortgages quoted for existing customers had not changed since February, while the average two-year fixed rate on mortgages had risen 0.16 percentage points, to 5.22%, in March. The effective mortgage rate had risen slightly, to 5.56% in February. According to the latest data from the Council of Mortgage Lenders, the share of new mortgages (by volume) with fixed rates fell to 38% in February, from 42% in January. The average quoted interest

rate on postal and telephone deposits along with deposit rates for time and instant access accounts had remained broadly unchanged in March. The average quoted interest rate on credit card borrowing had increased in March to 16.22%, while the effective rate for a personal loan had edged upwards to 8.88% in February.

A44 Three-month on three-month house price inflation measured by the Nationwide index had fallen to 0.7% in March, from 0.9% in February. The equivalent inflation rate measured by the Halifax index had risen slightly to 1.4% in March, from 1.1% in February. The number of loan approvals for house purchase had increased to 85,000 in February, from 82,000 in January. The monthly balance of net housing reservations reported by the House Builders Federation had remained broadly unchanged at -37.6 in February, from -37.8 in January. The ratio of sales prices to asking prices reported by Hometrack had risen by 0.1 percentage points, to 93.4%, in March.

A45 The annual growth rate of private non-financial corporations' (PNFCs') holdings of M4 deposits had fallen to 8.2% in February, from 10.3% in January. The annual growth rate of M4 lending to PNFCs (excluding the effects of securitisations) had fallen to 7.5% in February, from 8.1% in January. Total finance raised in the United Kingdom by PNFCs in February had been £3.1 billion (excluding the effects of securitisations), falling from £5.0 billion in January. Within total finance raised, the net flow of bond, equity and commercial paper issuance (denominated in sterling and foreign currencies) in February had been £0.2 billion, compared with -£1.2 billion in January.

A46 Household net wealth (including financial and housing assets) had grown 5.4% in 2004 Q4, compared with 0.3% in 2004 Q3. In 2004 Q4, the quarterly growth rate of household financial assets had risen by 3.0 percentage points to 4.4%, and the growth rate of household financial liabilities had fallen by 0.8 percentage points to 2.7%. Household capital gearing (net debt as a percentage of total assets, including housing wealth) had fallen slightly, to 18.4% in 2004 Q4 from 18.5% in 2004 Q3. Income gearing (total interest payments plus regular mortgage principal repayments as a percentage of annual post-tax household income) had risen to 11.7% in 2004 Q4, from 11.3%. The household financial balance had continued to be negative for the twelfth consecutive quarter, at -1.8% of post-tax income in 2004 Q4.

A47 PNFCs' capital gearing (net debt divided by the market value of the assets of UK-resident firms) had fallen to 31.6% in 2004 Q4, from 33.4% in 2004 Q3. PNFCs' income gearing (total interest

payments as a percentage of gross operating surplus) had increased by 0.8 percentage points to 19.7% in 2004 Q4. PNFCs' financial balance had increased to 10.3% of gross operating surplus in 2004 Q4.

A48 The current account deficit had been 1.7% of GDP in 2004 Q4 compared with 3.2% in 2004 Q3. Over 2004 as a whole, the current account deficit had risen to 2.2% of GDP, from 1.7% in 2003.

A49 The March HM Treasury survey of forecasters had shown an expected average annual rate of CPI inflation of 1.8% in 2005 Q4, compared with an expectation of 1.9% in the February survey. The March Consensus Economics survey had suggested that CPI inflation was expected to average 1.8% in 2005, 0.1 percentage points higher than in the February survey.

VII Reports by the Bank's Agents

A50 The Bank's regional Agents reported that the pace of consumer spending growth had softened further in the previous month. Retailing contacts had hoped for some boost from the Easter holiday period, but it seemed that none had materialised. New car sales had remained depressed and the growth of spending on consumer services had weakened, albeit to a lesser extent than the growth of retail sales. A number of factors had undermined consumer confidence, including the possibility of further interest rate increases, rising prices of utilities and petrol (which had reduced consumers' discretionary spending) and prospective Council Tax rises. The housing market had appeared to stabilise, with the number of housing transactions at levels closer to their historical average. Overall, house prices had been flat in recent months, though estate agents had expected some modest increases in the rest of 2005. The increase in the stamp duty threshold in the Budget would assist first-time buyers, largely in lower-priced regions.

A51 Contacts reported that wage settlements had risen modestly compared with the previous month. Factors that had put upward pressure on settlements had included increases in RPI inflation in the past year, past and prospective increases in the National Minimum Wage (which had knock-on effects on the pay of staff earning more than the minimum rate) and persistent skill shortages in some occupations. Even so, the gradual increase in pay pressures had not yet been a major concern for most contacts, partly on account of improvements in their labour productivity.