

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 July 2005, in advance of its meeting on 6-7 July. 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 June meeting, short-term interest rates had fallen in the United Kingdom at short maturities, but had risen in the United States and euro area. Sterling rates implied by December 2005 futures contracts had fallen by 18 basis points; dollar and euro implied rates for similarly dated contracts had risen by 24 and 8 basis points respectively. The publication of the MPC *Minutes* on 22 June and the release of weaker-than-expected figures for UK GDP growth in 2005 Q1 on 30 June had contributed to the falls in sterling rates. In the Reuters poll of economists published on 5 July, three out of 43 economists had expected UK rates to be reduced at the July MPC meeting, one had been undecided, while the remaining 39 economists had expected rates to remain unchanged. The mean expectation of economists for the Bank's repo rate at the end of 2005 had fallen to 4.46%, from 4.70% at the time of the June MPC meeting.

A3 Over the month, medium to long-term nominal forward interest rates implied by government bonds had changed comparatively little. UK ten-year forward rates had increased by 7 basis points, whilst in the United States and the euro area ten-year forward rates had increased by 7 and 11 basis points respectively. However, these moves had been relatively minor in the context of a downward trend in long-term forward rates which had been evident during previous months. The United Kingdom inflation forward curve, estimated using the prices on index-linked gilts, had shifted up slightly – by 6 basis points at the ten-year horizon – but its level continued to appear broadly consistent with the inflation target.

A4 The sterling effective exchange rate index (ERI) had depreciated by 2.0%, to 100.0, since the Committee's previous meeting. Sterling had depreciated by 4.4% against the dollar and by 1.2% against the euro, but had appreciated by 0.1% against the yen. Market commentary related some of the

sterling depreciation to UK data releases, including a downward revision to estimated GDP growth in Q1 and weaker-than-expected housing market data. Over the month, the US dollar ERI had risen by 2.9%; the euro ERI had been unchanged. The dollar had appreciated by 3.4% against the euro. One-year risk reversals from options prices had suggested that the perceived balance of risks to the US dollar against other major currencies were now skewed slightly to the upside.

A5 Since the Committee's previous meeting, the FTSE All-Share, EuroStoxx and Topix indices had risen by 4.4%, 3.1%, and 3.1% respectively in local currency terms, while the S&P 500 had changed little. All the major equity indices had risen in local currency terms since the publication of the *May Inflation Report*. Market views on near-term uncertainty surrounding the FTSE 100, as inferred from the three-month implied volatility of option prices, had changed little since the Committee's previous meeting, but had fallen slightly since the publication of the *May Inflation Report*. Sterling, dollar and euro-denominated investment-grade corporate bond spreads had narrowed or were little changed since the Committee's previous meeting.

II The international environment

A6 According to the final estimate, US GDP had risen by 0.9% in 2005 Q1, the same as suggested by the preliminary estimate. Within this, the estimate for consumption growth had been unrevised, at 0.9% on the quarter. Government spending had been unchanged on the quarter, unrevised from the preliminary estimate. Private fixed investment growth had been revised up, to 1.6% from 1.3%, in the preliminary estimate. Export growth had been revised up, to 2.2% from 1.7%, and import growth had also been revised up, to 2.3% from 2.2%. The US current account deficit had increased to 6.4% of GDP in 2005 Q1, from 6.3% in the previous quarter. Goods exports volumes had increased by 3.7% on the month in April, following growth of 0.6% in March; goods import volumes had grown by 3.4% in April, following a fall of 5.4% in March

A7 Real private consumption in the United States had been unchanged on the month in May, following an increase of 0.2% in April. The saving rate had increased to 0.6% of disposable income in May, from 0.5% in April. The Conference Board measure of consumer confidence had risen to 105.8 in June, from 103.1 in May. In the final estimate, the University of Michigan measure of consumer confidence had risen to 96.0 in June, from 86.9 in May.

A8 US industrial production had risen by 0.4% in May compared with the previous month, following a downwardly revised fall of 0.3% in April. The Institute for Supply Management (ISM) manufacturing index had increased to 53.8 in June, from 51.4 in May. The ISM non-manufacturing business activity index had risen to 62.2 in June, from 58.5 in May.

A9 US producer prices for finished goods had increased by 3.5% in the year to May, compared with a 4.8% rise in the year to April. The US headline consumer price index (CPI) had risen by 2.8% in the year to May, compared with 3.5% in April. The 'core' CPI, which excludes food and energy prices, had risen by 2.2% in the year to May, as it had in April.

A10 According to the second estimate, French GDP had increased by 0.3% in 2005 Q1, revised up from an estimate of 0.2% in the previous release. The estimated contribution of final domestic demand to Q1 GDP growth had been revised up, while the contribution to growth from net trade had been revised down and the contribution from stocks had remained unchanged from the first release. Italian GDP had contracted by 0.5% in 2005 Q1, unchanged from the flash estimate. Fixed investment had fallen by 0.6% on the quarter, while consumption and government expenditure had both increased by 0.2%. Exports had fallen by 4.1%, while imports had fallen by 2.4%.

A11 Euro-area retail sales had increased by 1.1% in May compared with the previous month, following a fall of 1.1% in April. The European Commission's consumer confidence indicator for the euro area had been -15 in June, unchanged from May. The euro-area unemployment rate had fallen to 8.8% in May, from 8.9% in April.

A12 Industrial production in the euro area had increased by 0.6% on the month in April, following a 0.1% fall in March. The European Commission's industrial confidence indicator for the euro area had increased to -10 in June, from -11 in May. The euro-area purchasing managers' index (PMI) for manufacturing had risen to 49.9 in June, from 48.7 in May. The euro-area PMI for services had fallen to 53.1 in June, from 53.5 in May. The German IFO index had increased to 93.3 in June, from 92.9 in May.

A13 Annual inflation in the euro area, as measured by the harmonised index of consumer prices (HICP), had fallen to 1.9% in May, from 2.1% in April. Annual 'core' inflation (excluding energy, food, alcohol and tobacco prices) had been 1.6% in May, up from 1.4% in April. According to the

Eurostat flash estimate, euro-area annual HICP inflation had risen back to 2.1% in June. Annual producer price inflation (excluding construction) had been 3.5% in May, compared with 4.3% in April.

A14 According to the second estimate, Japanese real GDP had grown by 1.2% in 2005 Q1, revised down from growth of 1.3% in the previous release. Private consumption had increased by 1.1%, business investment had increased by 2.4% and government spending had risen by 0.3% on the quarter. Net trade had contributed -0.1 percentage points to quarterly GDP growth, while stocks had contributed 0.3 percentage points.

A15 In Japan, industrial production had fallen by 2.3% on the month in May, after rising by 1.9% in April. Annual growth in export volumes had been -2.5% in May, down from -1.4% in April. Annual growth in import volumes had been 8.7% in May, from -0.6% in April. The all-activity index had risen by 1.7% in April, compared with the previous month. According to the Bank of Japan's Tankan survey for June, the large manufacturers' business conditions diffusion index had increased by 4 points, to 18, and the large non-manufacturers' business conditions diffusion index had also increased by 4 points, to 15.

A16 Since the Committee's previous meeting, the spot price of Brent crude oil had risen by \$6.66 to \$58.54 per barrel, an increase of 12.8%. Over the same period, the sterling spot price of Brent crude oil had risen by 18.0%, to £33.30 per barrel. The Economist dollar non-oil commodity price index had fallen by 1.5% over the same period.

III Money, credit and nominal trends

A17 The twelve-month growth rate of notes and coin had fallen to 3.8% in June, from 4.2% in May. The three-month annualised growth rate had increased to 2.6% in June, from 1.5% in May. The annual growth rate of aggregate M4 had increased to 11.6% in May, from 10.8% in April, the highest rate since December 1997. The annual growth rate of M4 lending (excluding the effects of securitisations) had increased to 12.6% in May. Excluding other financial corporations, annual M4 growth had increased to 9.1% in May, from 8.6% in April, while annual M4 lending growth (excluding the effects of securitisations) had edged downwards, by 0.1 percentage points, to 11.5% in May.

A18 The annual growth rate of households' M4 had been unchanged in May, at 8.7%. 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 0.2 percentage points, to 11.5% in May. The annual growth rate of secured lending to individuals had decreased to 11.1% in May, from 11.4% in April, while the annual growth rate of unsecured lending to individuals had decreased to 13.2% in May, from 13.4% in April. Within unsecured lending, the annual growth rate of credit card lending had been unchanged in May at 19.6%, while the annual growth rate of other unsecured lending had decreased to 10.7% in May, from 10.9% in April.

A19 At 6.61%, the average standard variable rate on mortgages quoted for existing customers had been unchanged from May, while the average two-year fixed rate on mortgages had fallen by 0.12 percentage points, to 4.85% in June. Effective mortgage rates had been 5.51% in May, unchanged from April. According to the latest data from the Council of Mortgage Lenders, the share of new mortgages (by volume) with fixed rates increased to 44% in May, from 42% in April. The average quoted interest rate on postal and telephone deposits had been unchanged in June, at 3.82%, while the rate on time deposits had increased by 0.07 percentage points, compared with May, to 3.09%, and the rate on instant access deposits had decreased by 0.02 percentage points, to 2.01%. The average effective interest rate on all credit card lending at 11.04%, had changed little in May, while the effective rate for a personal loan had edged downwards, to 7.21% in May.

A20 Three-month on three-month house price inflation measured by the Halifax index had fallen to -0.3% in June, from 0.1% in May. The equivalent inflation rate measured by the Nationwide index had risen slightly, to 0.8% in June from 0.7% in May. The number of loan approvals for house purchase had increased to 96,000 in May, from 95,000 in April. The monthly balance of net housing reservations reported by the House Builders Federation had fallen to -51.2 in May, from -49.9 in April. The ratio of sales prices to asking prices reported by Hometrack had fallen by 0.1 percentage points, to 93.5%, in June.

A21 The annual growth rate of private non-financial corporations' (PNFCs') holdings of M4 had picked up strongly to 10.9% in May, from 8.1% in April. The annual growth rate of M4 lending to PNFCs (excluding the effects of securitisations) had fallen to 12.2% in May, from 12.3% in April. Total finance raised in the United Kingdom by PNFCs in May had been £1.5 billion (excluding the effects of securitisations), falling from £2.4 billion in April. Within total finance raised, the net flow

of bond, equity and commercial paper issuance (denominated in sterling and foreign currencies) in May had been –£1.4 billion, compared with –£0.9 billion in April.

A22 Household net wealth (including financial and housing assets) had grown by 1.2% in 2005 Q1, compared with 3.2 % in 2004 Q4. In 2005 Q1, the quarterly growth rate of household financial assets had fallen by 2.8 percentage points, to 1.6 %, and the growth rate of household financial liabilities had fallen by 1.0 percentage points, to 1.9%. Household capital gearing (net debt as a percentage of total assets, including housing wealth) had risen to 18.5 % in 2005 Q1, from 18.4 % in 2004 Q4. Income gearing (total interest payments plus regular mortgage principal repayments as a percentage of annual post-tax household income) had remained at 11.8% in 2005 Q1. The household financial balance had risen in line with the saving ratio, to –2.2% of post-tax income in 2005 Q1, from –3.3% in 2004 Q4. This was the fifteenth consecutive quarter of financial deficit.

A23 PNFCs' capital gearing (net debt divided by the market value of the assets of UK-resident firms) had fallen to 31.2% in 2005 Q1, from 31.6% in 2004 Q4, reflecting increases in equity prices. PNFCs' income gearing (total interest payments as a percentage of gross operating surplus) had edged upwards, by 0.5 percentage points, to 20.0% in 2005 Q1. PNFCs' financial balance had decreased to 6.1% of gross operating surplus in 2005 Q1.

A24 The June HM Treasury survey of forecasters had shown an expected average annual rate of CPI inflation of 1.9% in 2005 Q4, compared with an expectation of 1.8% in the May survey. The June Consensus Economics survey had suggested that CPI inflation was expected to average 1.9% in 2005, 0.1 percentage points higher than in the May survey.

IV Demand and output

A25 The *Quarterly National Accounts* for 2005 Q1, consistent with the 2005 *Blue Book*, had been published on 30 June. Estimated GDP growth, at both basic and market prices, in Q1 had been revised down by 0.1 percentage points to 0.4%. The majority of the revisions in the latest release had affected GDP and its components back to 2002 Q1, but a number of specific revisions had stretched back as far as 1996. The cumulative effect of the revisions had been to increase the estimated level of GDP at market prices in 2005 Q1 by 0.6%.

A26 On the expenditure side of the accounts, quarterly growth in domestic demand had been estimated at 0.2% in 2005 Q1, up from 0.1% in the previous release. Within domestic demand, final domestic demand growth had been revised down to 0.2%, from 0.3% in the previous release. The contribution of stockbuilding (including the quarterly alignment adjustment) to overall GDP growth had been revised up, by 0.1 percentage points, to 0.0 percentage points in Q1.

A27 The estimated growth of households' consumption (including that of non profit-making institutions serving households) had been revised down by 0.2 percentage points, to 0.1% in 2005 Q1. In contrast, household consumption growth had been revised up in 2004 Q4, to 0.6% from 0.3% in the previous release. The cumulative effect of revisions to past data had been to raise the estimated level of household consumption by 1.4% in 2005 Q1 relative to the previous release. Business investment growth had been estimated at 0.1% in Q1, revised up from -0.1% in the previous release. Whole-economy investment growth had also been revised up, to -0.1% in Q1, from -0.4% in the previous release. The cumulative effect of revisions to past data had been to lower the estimated level of whole-economy investment by 2.9% in 2005 Q1 relative to the previous release.

A28 The estimated level of government consumption expenditure had been revised down by 0.2% in 2005 Q1. In the latest quarter, government consumption expenditure growth had been unrevised, at 0.7%.

A29 Excluding the effects of identified missing trader intra-community (MTIC) fraud, estimated export and import growth had been -0.7% and -1.1% respectively in 2005 Q1. Net trade had made an estimated 0.1 percentage point contribution to growth in 2005 Q1, down from the 0.4 percentage point contribution that had been estimated in the previous release.

A30 On the output side of the National Accounts, the service sector had grown at an estimated 0.7% in Q1, down from 0.8% in the previous release. Estimated service sector output growth was also revised down, by 0.2 percentage points to 0.8% in 2004 Q2, and by 0.3 percentage points in 2004 Q3 and Q4, to 0.7% and 0.6% respectively. Manufacturing output had fallen by an estimated 0.9% in Q1, down from -0.7% in the previous release.

A31 On the income side of the accounts, upward revisions to household consumption and downward revisions to household income had caused the ONS to lower its estimate of the household saving ratio

for the most recent years. In Q1, households' real post-tax income had risen by 1.1% on the quarter. Household consumption had grown more slowly than income in Q1, so the household saving ratio had risen, to 4.8% in Q1 from 3.9% in 2004 Q4.

A32 The gross operating surplus of corporations (excluding the quarterly alignment adjustment) had risen by an estimated 1.8% in 2005 Q1. The gross trading profits of private non-oil, non-financial corporations had grown by an estimated 0.7% on the quarter in 2005 Q1, and by an estimated 4.4% compared with the same period a year earlier.

A33 Turning to indicators of output in 2005 Q2, industrial production had grown by an estimated 0.1% in May, following an increase of 0.5% in April. Manufacturing output had been flat in May, while energy output had risen by an estimated 0.3%. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey output index had risen to 49.7 in June, from 47.9 in May, and the new orders index had also risen, to 50.8 in June from 45.5 in May. The expected output balance and total orders balance in the *CBI Monthly Trends Enquiry* had both fallen on the month. The former had fallen to -5 in June, from -1 in May; the latter had fallen to -25 in June, from -22 in May. The CIPS *Report on Services* business activity index had risen to 55.8 in June, from 55.1 in May. The incoming new business index had also risen, to 56.2 in June, from 55.4 in May. The survey had continued to point to strong service sector output growth in Q2.

A34 Turning to indicators of expenditure in 2005 Q2, retail sales had grown by 0.1% in May, following growth of 0.5% in April. In the *CBI Distributive Trades Survey*, the balance of retailers reporting positive annual growth in sales volumes had fallen to -19 in June, from -7 in May. According to the BRC-KPMG *Retail Sales Monitor*, retail sales values had grown by 3.5% in the twelve months to June. The GfK consumer confidence balance had also fallen slightly, to -3 in June from -1 in May. According to the Society of Motor Manufacturers and Traders (SMMT), new private car registrations had been 6.3% weaker in the three months to June than in the same period a year earlier.

A35 Excluding oil and erratics, goods export volumes had risen by an estimated 3.9% in April. Goods imports (excluding oil and erratics) had increased by an estimated 2.3%.

V Supply

A36 The annual growth rate of whole-economy labour productivity measured using numbers employed had been 1.3% in 2005 Q1, compared with 1.4% in 2004 Q4. The annual growth rate of whole-economy labour productivity measured using hours worked had been 1.0% in 2005 Q1, compared with 0.7% in 2004 Q4. The annual growth rate of whole-economy unit wage costs had been 3.2% in 2005 Q1, compared with 2.6% in 2004 Q4.

A37 According to the Labour Force Survey (LFS), employment had increased by 11,000 in the three months to April compared with the three months to January. In the three months to April, the 16+ employment rate had fallen by 0.1 percentage points, to 60.1%, compared with the three months to January, and had been unchanged compared with the same three-month period a year earlier. Average hours worked had fallen by 0.7% in the three months to April compared with the previous non-overlapping quarter, to 32.1.

A38 The CIPS/NTC employment index from *Deloitte/REC Report on Jobs* had pointed to moderate growth in employment. The overall CIPS employment index for June had risen to 51.0. Within this, the services, manufacturing and construction indices had risen.

A39 LFS unemployment had fallen by 15,000 in the three months to April, and had been 37,000 lower than a year earlier. The LFS unemployment rate had been 4.7% in the three months to April, unchanged compared with the previous non-overlapping quarter, but 0.2 percentage points lower compared with the same period a year earlier. The claimant count unemployment rate was unchanged at 2.7% in May. The level of 16+ inactivity had increased by 77,000 in the three months to April. The 16+ inactivity rate had risen to 37.0% in the three months to April, up by 0.1 percentage points compared with the previous non-overlapping quarter, and up by 0.1 percentage points compared with the same period a year earlier.

A40 The annual growth rate of private sector capital had been unchanged in 2005 Q1, compared with 2004 Q4.

VI Costs and prices

A41 According to settlements information available to the Bank, the mean whole-economy twelve-month average earnings index (AEI-weighted) settlement had been 3.5% in the year to May. The twelve-month mean settlement in the private sector (AEI-weighted) had been 3.7% and in the public sector (sample-weighted) had been 3.1%.

A42 Overall whole-economy annual earnings growth had been 4.6% in the three months to April, 0.1 percentage points higher than in the three months to March. Private sector pay growth had increased by 0.1 percentage points, to 4.7% in the three months to April. Public sector pay growth had also increased by 0.1 percentage points, to 4.6% in the three months to April. Whole-economy annual earnings growth excluding bonuses was unchanged at 4.1% in the three months to April, compared with the three months to March.

A43 Manufacturing input prices had risen by 0.3% in May. This meant that the annual inflation rate had fallen to 7.8% in May, from a revised 10.2% in April. The *CIPS Report on Manufacturing* input price balance had fallen to 50.5 in June, from 53.1 in May.

A44 Manufacturing output prices excluding duties (PPIY) had fallen by 0.2% in May. Annual inflation had fallen to 2.8% in May, from 3.5% in April. The balance on expected output prices from the *CBI Monthly Trends Enquiry* had fallen to -6 in June, from -3 in May.

A45 According to the National Accounts, the annual inflation rate of the GDP deflator at market prices had been 2.4% in 2005 Q1, unchanged from a revised 2.4% in 2004 Q4. Within this, the annual inflation rate of the household consumption deflator had increased to 1.4% in 2005 Q1, from 1.1% in 2004 Q4. The annual inflation rate of the government consumption deflator had fallen to 4.8% in 2005 Q1, from 4.9% in 2004 Q4. The annual inflation rates of the imports and exports deflators had been 3.3% and 3.1% respectively in 2005 Q1.

A46 Annual CPI inflation had been unchanged at 1.9% in May. Within this, annual goods price inflation had fallen by 0.3 percentage point to -0.1%, and annual services price inflation was 0.2 percentage points higher, at 4.2%. Annual RPIX inflation was 0.2 percentage points lower in May, at 2.1%. Annual RPI inflation was 0.3 percentage points lower at 2.9% in May.

A47 The Bank's regional Agents had conducted an informal survey of around 230 firms, covering over 400,000 employees, on pay flexibility. All firms in the survey had indicated that they pay basic pay and over 75% had suggested that they also provide some or all of: overtime, performance-related pay, pensions and non-cash benefits. Overtime had decreased in importance within the overall pay bill, while all other payment types, particularly performance-related pay, had become more important over the recent past. The survey had suggested that firms had instigated that change primarily to link pay to profits and to reward productivity. Recruitment and retention, individual performance and local pay comparisons had been highlighted as the main factors influencing basic pay, whereas company profits and individual performance had been pointed to as the main influences on other elements of remuneration.

VII Reports by the Bank's Agents

A48 The Bank's regional Agents had reported that consumer demand remained subdued. But the picture had been mixed. Demand for big-ticket household goods such as furniture had weakened further. The volume of sales for some other goods, such as home electronics, had still been rising, but that was driven by strong deflation, so the value of sales had been broadly flat. Overall, the value of retail sales had been a little weaker compared with a month earlier. Demand for consumer services had held up a little better, but some sectors were seeing slower growth.

A49 The manufacturing sector had continued to weaken. Apart from continued reports about the loss of market share to cheaper overseas competitors, the slowing in consumer demand had also had an impact. If anything, manufacturers' exports had fared a little better than domestic sales in recent months. Some sectors were performing better, particularly those supplying the public sector and construction infrastructure projects.

A50 Agents' contacts had reported an easing in employment growth in recent months. The fall in manufacturing employment had continued, but was now coupled with an easing pace of job creation in the retail and public sectors. One factor that contacts often highlighted was the slower pace of job turnover compared with previous years – probably because workers were cautious about the economic outlook. There had also been signs that recruitment difficulties might have been easing.