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MINUTES OF MONETARY POLICY COMMITTEE MEETING

5 and 6 August 1998

These are the minutes of the Monetary Policy Committee meeting held on 5 and 6 August 1998.

They are also available on the Internet (<http://www.bankofengland.co.uk/mpc9808.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released no later than 6 weeks after each meeting. Accordingly, the minutes of the Committee meeting held on 9 and 10 September will be published on 14 October 1998.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING ON 5-6 AUGUST 1998

1. In reviewing recent news in the course of finalising its August inflation forecast and taking its immediate policy decision, the Committee discussed the international environment and external price developments; the evidence from official data of a slowdown in domestic demand and output growth; indicators of the future path of output, including recent surveys; labour market conditions, and the implications of the National Minimum Wage; the Government's recent spending announcements; monetary conditions; and recent outside forecasts.

The international environment

2. The Committee discussed the international environment against the background of its August Inflation Report. It agreed that the outlook for Japan and the rest of Asia had not changed much since its July meeting; the Japanese economy was certainly no better, and if anything perhaps slightly worse. By contrast Europe was still thought likely to grow in line with the May forecast assumptions.

3. The US economy was key to global prospects, and members noted that while growth had so far broadly followed the path expected in May, the uncertainties about the outlook had increased. Output growth had slowed somewhat in Q2, reflecting weaker net trade and stockbuilding contributions. But domestic demand growth remained strong, and continued rises in employment and earnings were sustaining growth in real personal disposable incomes. The outlook was potentially vulnerable to sudden change. The rate of broad money growth was still rising and unemployment was at historically low levels, possibly below the natural rate. It was accordingly plausible that domestically generated inflationary pressures were increasing. Headline inflation had perhaps so far been held down by benign external conditions and a strong dollar, as well as the high credibility of the Fed, which faced a delicate task in balancing domestic and international considerations.

4. Two particular risks were identified. First, that the US economy would turn down sharply in the face of an actual or expected tightening of monetary policy. Second, even in the absence of tighter monetary conditions, the equity market might fall. Equity prices were regarded by some commentators as reflecting highly optimistic expectations of corporate earnings growth as well as a much reduced

equity risk premium (the extent to which equities were required to yield a higher return than government bonds on account of more uncertain returns). Arguably the fall in the days leading up to the Committee's meeting had increased the risk of a substantial fall in equity prices. But just as the probability and the scale of any market fall were uncertain, so were the consequences if it occurred. The macroeconomic impact of the large fall in October 1987 had in the event been small, although it was difficult to judge to what extent this was in fact due to offsetting effects from the loosening of monetary policy. However, the pattern of equity ownership had changed materially since then, partly through the growth of mutual funds, which had increased the personal sector's near-direct holdings of equities. It was therefore possible that an equity market fall would now hit consumer confidence and consumption via reduced wealth more than had been the case in the past.

5. The Committee felt that the balance of risks relating to future activity in the US and Japan were on the downside of the August central projection. It had therefore incorporated in its forecast a downside risk to UK output growth, and hence to inflation, from weaker than expected world activity in 1998 and 1999.

6. Also in the context of the external environment, the Committee noted that input price pressures remained benign because of further falls in world commodity prices and the continuing adjustment of import prices to sterling's past appreciation.

Pace of the domestic slowdown so far

7. The Committee agreed that there was now clear evidence that the economy had been slowing over the past year. The annualised growth rate of GDP had fallen from 2.9% and 3.0% through the first and second halves of 1997 respectively to an ONS estimate of 2.1% in 1998 H1. Growth in final domestic demand (ie excluding stockbuilding) had fallen from 4.6% in 1997 H1 to 4.0% in 1997 H2, and probably further in 1998 H1 given the indicators of Q2 demand so far available (for example, retail sales and car registrations).

8. Within total output, services growth had fallen from 4.7% (annualised) in 1997 H2 to 2.5% in 1998 H1. Manufacturing output growth was now at best flat. Within total final domestic demand, there were signs that retail sales growth had slowed, although some members of the Committee thought this could be attributed at least in part to recent bad weather and other special factors (eg the World

Cup). Data on housing market activity - and closely related items of consumer spending - suggested a slight easing in demand pressures.

9. The Committee had projected a slowdown in domestic demand in its previous inflation forecasts but at that point there had still been considerable uncertainty as to whether it was underway. That uncertainty was now convincingly resolved. The slowdown also seemed so far to be less unevenly distributed across the different sectors of the economy than had previously been expected.

10. There remained, however, considerable uncertainty about the level of activity relative to the economy's productive capacity. One of the puzzles in the latter part of 1997 had been the persistent strength of surveys compared with the official data. It was still possible that the ONS estimates of past activity and demand might have under-recorded the strength of the economy. The Committee noted that there would be many changes to the National Accounts in September, including rebasing, implementation of the new European System of Accounts, and a new Inter-Departmental Business Register: it would need carefully to examine all of these changes as well as the usual revisions as further information became available to the ONS.

Indicators of future growth

11. More recently, and especially just prior to the Committee's July meeting, a series of surveys had suggested that there had been a sharp fall in business, and somewhat less so in consumer, confidence. For example, the MORI index of consumer confidence had fallen from +1 in May to -19 in June, while the GFK measure had fallen from +1.2 in June to -1.6 in July. In surveys of manufacturing, the BCC, CIPS and CBI measures had deteriorated materially over the quarter, with all appearing consistent with falling activity. The services sector measures - for example the CIPS activity and new business indices - generally signalled continuing growth, but at a slower pace than in April. (The Committee noted that there were still far fewer surveys of the services sector than of the smaller manufacturing sector.)

12. Interpretation of the survey evidence was felt to be difficult. First, it was not clear what had triggered the apparent sharp change in sentiment. One possibility was that the Committee's June tightening, which had surprised financial markets, had induced a changed perception of the likely path of monetary policy. There was some support for this in the reaction of markets to subsequent earnings data, as the Committee had highlighted the pick up in earnings growth as one of the main factors behind its June decision. Alternatively, the lagged effects of past monetary tightenings and sterling's

appreciation might now be becoming more obviously apparent to consumers and businesses. Another possibility, which could not be dismissed out of hand, was that the confidence indicators - and the publicity surrounding them - were in some degree feeding on each other.

13. A second issue was whether, in addition to giving signals on the direction of the economy, the surveys provided information on the likely scale and speed of the slowdown. Few surveys had been in existence long enough for a robust view to be reached on this; many had not yet seen one complete business cycle. The CBI Business Optimism measure did, however, seem to have been a reasonable leading indicator in recent cycles. Taken on its own, it appeared to indicate a sharp downturn in activity.

14. Moving on to other evidence, the Committee noted that the messages about activity conveyed by the Bank's regional Agents had also become bleaker. Most striking was the sense that the downturn was not restricted to parts of the country with a proportionally large manufacturing presence and was extending to southern England. Some of the considerations bearing on the surveys applied here too, but the Agents' evidence nevertheless broadly corroborated a steeper and more broadly based slowdown than previously expected.

15. Finally, the rise in the number of profit warnings issued by quoted companies also suggested an accelerating slowdown. Some of the downside risks to equity prices incorporated in the May *Inflation Report* seemed to be materialising. The Committee agreed that the downside risks remained, particularly in the light of apparently greater fragility in the US equity market. Consumption would, however, tend to be supported by the effects of past equity price increases and projected robust labour income growth.

16. Overall, the economy had so far slowed broadly in line with the Committee's May forecast. The short-run outlook for activity was now slightly weaker than assumed in May and, given the recent surveys, the downside risks had probably increased.

Labour market conditions

17. While recent demand and activity data and survey indicators made it clear that the economy was slowing, the sustained above-trend growth of previous years was putting accumulating pressures on capacity. In particular, further increases in the demand for labour had become more of a concern in recent months. On the LFS measures, employment had risen in the three months to May compared with the previous three months, while the unemployment rate had fallen to 6.3% in May. Employment intentions, as measured by surveys, remained strong in the services sector, but were falling in manufacturing. According to the British Chambers of Commerce, recruitment difficulties were at a record high in both sectors in Q2. There were, however, some signs of easing in recent data: the claimant unemployment count had risen for the second month running to 4.8% in June, and the CBI had recorded fewer reports of skill shortages in manufacturing in its July survey.

18. More striking was the sharp rise in measures of earnings growth during the spring, as discussed at the Committee's June and July meetings. Headline whole-economy average earnings growth in the three months centred on April was 5.4% (private sector 6.2%, public sector 2.8%), having increased from 4.6% (revised up from 4.5%) in January. The amounts identified by respondents to the ONS survey as "irregular pay", which seemed likely to represent mainly bonuses, contributed 0.2 percentage points to the 1.1 percentage point increase in annual average earnings growth over the year to April 1998, suggesting that the acceleration of labour costs was only to a degree the result of increasing bonuses.

19. The Committee noted that the increasing importance of bonuses and profit/performance-related pay in remuneration complicated the assessment of labour market conditions. In particular, since most firms paid bonuses in a single month, the bonus contribution had to be smoothed over the year to obtain a measure of the underlying change in earnings growth. This required an assumption about the rate of growth in bonus payments over the coming twelve months. Assuming that bonuses continued to increase at the same rate as over the past year, underlying earnings growth in May was 5.2%, calculated on this basis. If, on the other hand, bonus growth fell to 10% by 1999, the smoothed earnings growth figure for May would be around 4.9%; and for zero bonus growth by January 1999, the figure was 4.7%. The assumption about future bonus growth was therefore an important element in judging current underlying earnings growth, although it was noted that since 1996 earnings growth had picked up steadily on any measure.

20. Views varied amongst Committee members about the best assumption. On one view, past bonus growth reflected rapid growth in corporate profits and revenue, which was unlikely to continue through

1998-99 given the activity slowdown underway. On another view, bonus growth was in part a symptom of a tight labour market, with firms having to pay up to recruit and keep labour.

21. The Committee discussed arguments advanced in the press that the official numbers materially overstated the rate of earnings growth because of the way bonuses were treated, and that there had been no real acceleration in earnings. But even on evidence as presented there had clearly been an increase in the rate of earnings growth.

22. The Committee discussed the twelve-month and three-month annualised measures of settlements growth. The twelve-month employment-weighted mean for the whole economy was 3.8% in Q2, up from 3.5% in Q1, while the three-month mean settlement had fallen from 3.9% to 3.7% over the same period. The twelve-month rate could potentially mislead as it reflected settlements agreed up to a year ago, and so possibly before the prospect of a slowdown had become widely apparent. However, the three-month measure was probably more misleading. Different firms settled in different months, so that the range of employers included in the three-month measure changed from month to month. In particular, the timing of public sector settlements distorted the three-month measure.

23. There was a range of views on the likely pace of future earnings growth, but members agreed that the labour market was tighter, and thus upward pressures on earnings were greater, than a quarter ago. One view was that the prospective slowdown in demand and output would dampen earnings growth, which was a lagging indicator of the economy. Another was that there would be continuing increases. In particular, there was a risk that public sector pay would start to catch up with the private sector, as discussed at previous meetings. The slowdown in domestic demand might, though, reduce the ability of firms to pass higher labour costs into prices, which the Committee agreed to reflect in its central projection.

24. The Committee also discussed recently published research suggesting that official estimates understated productivity, and so overstated unit labour cost growth, in manufacturing. Members noted that the research was specific to manufacturing and had no implications for the accuracy of official estimates of productivity and unit labour costs in the whole economy, which was the Committee's focus. The authors of the research had said that any errors in the measures of manufacturing were likely to be offset by countervailing errors in the measures for other industry groups.

25. The Committee discussed the implications for inflation of the National Minimum Wage due to take effect from April 1999; a Box on the MPC's analysis would appear in the August *Inflation Report*. The introduction of the National Minimum Wage (NMW) was akin to a price level shock. It would raise the price level, with a temporary impact on inflation. There was an upside risk that there would be more restoration of wage differentials than assumed in the central projection. Faster earnings growth in 1998 and 1999 than had been assumed in May, together with the NMW, would change the profile of the central projection of RPIX inflation, in the direction of making it humped rather than saucer-shaped.

Fiscal policy

26. The Committee discussed the implications for the inflation outlook of the latest Government spending announcements (in the Economic and Fiscal Strategy Report and the Comprehensive Spending Review). Fiscal policy had been progressively tightened in recent years. Following the latest announcements, the starting point in the EFSR was a somewhat lower fiscal deficit in 1997/98 than in the March Budget and May *Inflation Report*. There appeared to be an increase in current as well as in public investment spending from 1999/2000 onwards compared with the illustrative assumptions in the March Budget. The March Budget had, though, still effected reductions in forecast future deficits compared to 1997/98. It was observed that the budget balance was not by itself a complete measure of the macroeconomic impact of fiscal policy, which was also affected by changes in the level and composition of planned expenditure. These changes were reflected in the central projection.

Monetary conditions

27. The Committee noted that the rate of growth of most of the money and credit numbers had fallen over both the quarter and the latest month, and quite markedly since the peaks in 1997. Compared with May, there were clearer signs that monetary growth had eased. However, with the possible exception of narrow money, whose three-month annualised rate of growth was around 4% in July, further falls were needed in the absence of persuasive reasons to expect continuing strong negative velocity growth. On one view, additional risks were posed by a possible liquidity overhang from cumulative past rapid broad money growth.

28. Consumer credit had continued to rise very rapidly. It seemed that, notwithstanding the increases in official rates, intense competition had prevented interest rates from rising on unsecured credit

products over the past year or so. It was unclear what if any implications this had for future consumption growth, particularly given that mortgage equity withdrawal had been negative in recent quarters.

29. As regards price indicators of monetary conditions, the Bank staff's estimates of short maturity real interest rates suggested a fall over the past month but a rise since May, mainly owing to the change since the June tightening in expected future official rates. However, sterling had fallen over both the past month and compared with the *May Inflation Report* assumption.

Other forecasts of inflation

30. The Committee reviewed information collected up to the meeting on other forecasts; as usual the completed survey would be summarised in the *Inflation Report*. So far, the averages for RPIX inflation in 1998 Q4, 1999 Q4 and 2000 Q3 were 2.6%, 2.5% and 2.5% respectively; and for GDP growth they were 1.4%, 1.7% and 2.2%. These forecasts did, of course, make a variety of assumptions about the path of interest rates and the exchange rate.

The MPC's August forecast

31. On the Committee's own forecast, which is described fully in the *Inflation Report* published in the week following the meeting, the near-term outlook for output growth was weaker than in May. As in previous quarters there was a negative contribution from net trade through much of the forecast period, but this was smaller than in May due to sterling's slight fall over the quarter and a steeper future depreciation being assumed in the central projection, reflecting a widening in interest rate differentials. The official figures for investment in 1996 and 1997 having been revised up, the Committee decided to reduce its forecast of investment growth, and so domestic demand growth, over the forecast period. Overall, therefore, in the central projection output growth fell below trend before rising as the fall in net exports came to an end and as planned government spending picked up.

32. The inflation profile reflected the adverse news on earnings since May, which on its own implied a worse rate of inflation for a given rate of output growth (a worse short-run nominal/real trade-off). Not all members agreed with this interpretation of the earnings data. The alternative view was that the bonus elements of earnings was likely to slow as activity slowed. However, in the central projection, earnings now accelerated by more than assumed in May, and the effect of the National Minimum Wage

on the price level added to nominal earnings growth in the shorter run. Inflationary pressures would, however, subside somewhat as the economy slowed and unemployment rose. The central projection was thus for RPIX inflation to rise into 1999 before falling back.

33. The net effect of these influences was that the central projection for RPIX was above the 2.5% target until the end of the forecast period; and that May's saucer-shaped forecast was succeeded by a forecast with a hump. The balance of risks to inflation were on the upside towards the end of the period through, amongst other things, the possibility of a greater sterling depreciation than assumed in the central projection.

The immediate policy decision

34. The Committee first discussed to what extent it should weigh in its policy decision not only the medium-term outlook for inflation but also the hump in inflation which it was forecasting in the first half of 1999.

35. On one argument, the Committee should be concerned with the profile for inflation over the entire horizon at which current policy was likely to have some impact on inflation, not solely on the two-year ahead prospect. The central projection for inflation in the August Inflation Report was above the target throughout the entire forecast period, except at the two year horizon, with the prospect of a subsequent rise in inflation as domestic demand growth picked up. Moreover the balance of risks to inflation was on the upside. To eliminate the anticipated hump in inflation completely might require too much volatility in output in the short-run. Nevertheless, it would be appropriate to reduce that hump somewhat by a further immediate tightening of monetary policy. This would also help to bring down inflation at longer horizons. The inflation projection implied that over the two year horizon, in order to meet the inflation target, an increase in interest rates was more likely to be necessary than a cut. There were no pressing arguments for delaying an increase, and so an immediate increase was called for.

36. On another argument, the lags in monetary policy were such that raising rates to reduce the expected but uncertain hump in inflation in 1999 would raise output volatility without directly improving the medium-term outlook for inflation. This argument pointed to not raising interest rates immediately.

37. Turning to the implications for policy of the overall outlook for inflation, the Committee identified arguments for raising rates, for leaving them at 7.50%, and for cutting rates.

38. The arguments for raising rates were as follows. The central projection for inflation was above the target throughout the forecast period, except at the 2 year horizon. The risks to inflation were, moreover, on the upside throughout - and especially towards the end of - the forecast period, so that the mean projection of inflation was above 2 ½% throughout the forecast period. On one view, it seemed likely, notwithstanding the considerable uncertainties, that inflation would be increasing beyond the two-year horizon, as the effects of sterling's appreciation on net trade wore off and as the impact of government spending on domestic demand came through. Thus, just as inflation outturns had persistently been above target in the past, it was more likely than not that inflation would be above target in the foreseeable future. This would be damaging to credibility, and called for an immediate 25 basis point rise.

39. The arguments for a cut in rates were as follows. Current monetary conditions were already tight. Real short-term interest rates were probably in the range 4 ½-5% and the exchange rate was being held up partly by market expectations of official interest rates being set at the current level (or even higher) for some time. The downturn in the economy now becoming evident in the data was largely the effect of the monetary tightening put in place a year or so ago and the past appreciation of sterling. So far the downturn was moderate, but the more recent monetary tightenings were yet to have their maximum effect, and there were some ominous signs in the survey evidence and from the Bank's regional Agents that the decline in output growth might be about to steepen.

40. On this view these arguments pointed to an immediate, but small, reduction in interest rates, both to bring down their level directly and also to signal that official rates had probably peaked. Further support for this view came from a lower inflation forecast based on an alternative interpretation of bonus payments and earnings growth which assumed no change in the short-term nominal/real trade-off from that in the May projection. In that case it was unlikely that a 25 basis points reduction in rates would be enough to prevent inflation from being below target, especially if the downside risks of a deeper prolonged impact from the Asian crisis materialised. But there were arguments against a larger cut at this point. Domestically, there were some offsetting upward risks to inflation. Medium-term inflationary pressures had increased because of the introduction of the minimum wage and because of the expansionary effect of higher planned government expenditure. There was also a risk of further earnings acceleration, although on this view it would not be possible for producers to pass much of that

through to prices in the current environment. It was therefore desirable to reduce rates by 25 basis points now and then wait to see how earnings and prices developed before bringing rates down further.

41. The arguments for leaving rates at 7.50% were as follows. The slowdown in activity and demand so far was broadly in line with the Committee's earlier forecasts, resolving the earlier uncertainty about whether a turning point had been reached. The downturn also appeared so far to be somewhat more balanced than previously expected. On the other hand, the earnings data were clearly worse than expected in May, implying that the short-run nominal/real trade off had deteriorated. That would probably continue for a while, and was reflected in the Committee's forecast. While the risks to inflation were on balance on the upside, there were downside risks. In particular the forecast of consumption growth depended in part on private sector wealth and thus on the course of the equity market, which had recently become more rather than less uncertain. And the recent striking fall in consumer and business confidence, evidenced by surveys and the Bank's regional Agents, signalled downside risks to activity and inflation. These risks might be greater than reflected in the forecast. For example, the downturn might prove sharp enough to prevent the forecast rise in earnings growth being passed through into prices in the short run, although that would tend to increase latent price pressures beyond the two-year horizon, since margins would probably be rebuilt at some stage. In sum, given that inflation was forecast to be close to the target in two years' time and that the outlook beyond then was highly uncertain, the Committee could sensibly wait to gather more information before concluding that policy needed to be changed.

42. The Governor invited members of the Committee to vote on the proposition that the Bank's repo rate be left unchanged this month. Seven members of the Committee (the Governor, Mervyn King, David Clementi, Alan Budd, Charles Goodhart, Ian Plenderleith and John Vickers) voted for the proposition, and two (Willem Buiter and DeAnne Julius) voted against. Willem Buiter preferred an immediate rise in interest rates and DeAnne Julius an immediate cut.

43. The following members of the Committee were present:

Eddie George, Governor

Mervyn King, Deputy Governor responsible for monetary policy

David Clementi, Deputy Governor responsible for financial stability

Alan Budd

Willem Buiter

Charles Goodhart

DeAnne Julius

Ian Plenderleith

John Vickers

Andrew Turnbull was also present as the Treasury representative.

ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF

A1. This Annex summarises the analysis presented by Bank staff to the Monetary Policy Committee on Friday 31 July, in advance of its meeting. At the meeting itself, members were made aware of information that had subsequently become available, and that information is included in the Annex.

I Monetary conditions

A2. The twelve-month growth rate of notes and coins had risen to 5.6% in July from 5.5% in June, and the three-month and six-month annualised rates were 3.5% and 4.2% respectively, after adjusting for the effects of the introduction of the new 50p and £2 coins. Three-month annualised real narrow money growth had slowed to around 2%.

A3. Retail M4 had grown by 0.1% in June, bringing the three-month, six-month and twelve-month growth rates down to 5.1%, 4.5% and 5.6% respectively, from 5.5%, 5.1% and 6.7% in May. The fall in the twelve-month growth rate had partly reflected strong inflows to retail deposits in June 1997 following the Halifax Building Society demutualisation.

A4. The twelve-month growth rate of aggregate Divisia money had fallen to 7.9% in Q2, from 8.6% in Q1. Within the total, personal sector Divisia growth had remained unchanged at 6.9%, while ICCs' Divisia growth had fallen to 5.1% from 5.7% in Q1, and OFIs' Divisia growth to 16.6% from 23.1%. The twelve-month growth rate of aggregate real Divisia had fallen to around 5% in Q2. In the past 20 years the average annual fall in Divisia velocity had been around 1%; if that were the current rate, real Divisia growth of about 5% was consistent with real transactions demand growth of around 4% a year.

A5. Personal sector M4 growth had weakened in June, but had been relatively strong in Q2. The three-month annualised growth rate for Q2 was 6.6%, above the twelve-month growth rate of 6.2%.

A6. ICCs' M4 deposits had risen by 1.5% in Q2 — only slightly stronger than the 1.4% rate in Q1 — while the twelve-month growth rate had fallen to 5.3% from 5.8% in Q1. However, the rates of growth over shorter periods had been rising, the three-month rate picking up to 6.0% in Q2 from 5.5% in Q1, and the six-month rate to 5.8% from 4.4%.

A7. The 3.5% rise in OFIs' M4 in Q2 was the weakest quarterly increase since 1994 Q4, bringing the three-month annualised growth rate in Q2 to 14.9%. The three- and six-month growth rates had remained below the twelve-month growth rate of 19.9%. Asset allocation surveys carried out by Merrill Lynch suggested that LAPFs' cash to portfolio value ratio had fallen in June to 4.9%, which was close to the average since 1975.

A8. The twelve-month growth rate of aggregate M4 had fallen to 9.0% in June, despite relatively strong monthly growth of 0.7%. The three- and six-month growth rates had remained below 9%. Since 1997 Q2, when the twelve-month growth rate of M4 was 11.7%, persons' M4 growth had fallen from 7.7% to 6.2%, ICCs' M4 growth had fallen from 7.7% to 5.3%, and OFIs' from 27.8% to 19.9%.

A9. Real M4 growth had fallen by around 2 percentage points during 1998 — slightly above the 1.6 percentage point fall in nominal M4 growth. The twelve-month growth rate of real M4 lay somewhere between 6% and 7%, depending on which price series was used to deflate nominal money. The 20-year average growth rate of velocity had been around -2%; if that were the current rate, real M4 growth of 6%-7% suggested real demand growth of between 4% and 5%.

A10. Turning to credit, aggregate M4 lending growth had been weak in June, growing by 0.3% on the previous month. The three- and six-month growth rates had both fallen and the twelve-month growth rate had fallen to 7.6% from 8.2% in May.

A11. M4 lending to persons had remained steady: the twelve-month growth rate was 6.8 % in Q2 and had varied very little in the previous twelve months. Net secured lending had also been steady. Gross secured lending had been strong again in June, possibly reflecting continuing high levels of remortgaging. Unsecured lending had remained strong — the twelve-month rate had remained above 16% in June — within which net credit card borrowing (accounting for about 25% of the stock of unsecured credit to the personal sector) had grown at 25.5%.

A12. Lending to ICCs had fallen by 0.1% in June, bringing the twelve-month growth rate down to 5.2% from 5.5% the previous month. However, the three- and six-month rates were somewhat higher. Also, external finance from outside the M4 sector had remained strong in Q2, with total (sterling and foreign currency) external finance steady between Q1 and Q2.

A13. OFIs' M4 lending had weakened in Q2, the twelve-month growth rate coming down to 13.2% from 17.5% in Q1. Monthly growth had averaged 0.6% during Q2.

A14. Turning to financial prices, as expected banks had now largely passed on the most recent repo rate rise to both savings and variable rate mortgage rates, whereas mutual lenders had continued to delay. Unsecured personal credit rates had not risen. Average rates payable on fixed-rate mortgages had risen in July, with a range of banks and building society increasing rates significantly.

A15. Inflation expectations for 1998 — as measured by surveys of professional forecasters conducted by Consensus Economics (forecasts of average 1998 RPIX inflation) and HM Treasury (forecasts of 1998 Q4 RPIX inflation) and the Merrill Lynch survey of fund managers (forecasts of RPI inflation in the year to December 1998) — had edged up slightly in July; in each case most respondents had been surveyed before June's low RPI inflation outturn had been published.

A16. Sterling interest rate expectations, as derived from the futures markets, had fallen slightly in July — the three-month rate implied for September 1998 stood at 7.76% — but remained higher than immediately prior to the June repo rate rise. The nominal forward curve had risen slightly at the long end (around 9 basis points at the 20-year horizon) to 5.53%. The real forward curve had hardly moved at the long end. The implication was that either long-run inflation expectations or the inflation risk premium (or both) had risen slightly in July compared with June. There were, however, few clear macroeconomic explanations for any such development, and the increase was not large in comparison with the historical volatility of the series.

A17. The two-year forward rate (for 18-24 months), derived from index-linked gilts, had fallen by about 25 basis points over the month. There were no new survey-based estimates of short real rates available this month.

A18. The broad and narrow measures of the sterling ERI had fallen by 1.4% and 1.6% to 120.4 and 104.0 respectively since the 8-9 July MPC meeting. The ERI had fallen by 1.8% from the (15 day average) starting-point in the *May Inflation Report*. Using the uncovered interest parity condition to project the exchange rate from end-July levels now implied a path for sterling out to 2000 Q2 approximately mid-way between the mean and modal paths for sterling assumed in the *May Inflation Report*. Exchange rate forecasts taken from Consensus Economics implied a path reasonably close to the *May Inflation Report* mean.

A19. The Consensus forecasts can be used to provide a measure of the sterling risk premium (the excess return required on sterling assets above interest rate differentials); this was based, amongst other things, on an assumption that survey respondents' and market participants' expectations were the same. Comparing the April and July Consensus forecasts, it was noticeable that, while the forecast value for sterling in early 2000 was broadly unchanged, the estimated risk premium on other currencies relative to sterling had fallen by around 1.5 percentage points, from around 4% to around 2.5%. Most of this fall had occurred between the April and May Consensus surveys, and might have

been associated with the “Euro weekend” at the start of May. The effect of this estimated fall in the risk premium on sterling had subsequently been offset by an increased differential in market interest rates - expectations of future UK interest rates had risen after June’s increase in the repo rate.

II Demand and output

A20. Recent data had suggested a further slowdown in underlying economic growth. The preliminary estimate of GDP growth for 1998 Q2 was 0.5%, the same as in Q1. But the Q2 figure had been boosted by strong energy output. Non-oil GDP grew by 0.4% compared with 0.6% in 1998 Q1. Annual GDP growth had moderated from 3.0% in Q1 to 2.6% in Q2.

A21. There was as yet only a limited sectoral breakdown of the Q2 output data. Service sector output had grown by 0.6% in Q2 (0.7% in Q1). That compared with an average quarterly growth rate of 0.9% for the recovery period as a whole; and growth over the latest two quarters had been much less than in 1997, reflected in six-month annualised growth rates of 2.6% in 1998 H1 compared with a peak of 4.7% in 1997 H2. Within services, distribution output had risen by 0.1% in Q2, though the figure was typically revised. The relative weakness partly reflected the fall in car sales in Q2.

A22. Manufacturing output was unchanged in June, having fallen by 0.4% in May. Consequently output was unchanged in the second quarter compared with the previous quarter. The trend in manufacturing output since mid-1997 appeared to have been, at best, flat.

A23. The recent pattern of monthly retail sales data had been particularly volatile, in part reflecting the impact of the poor weather. Sales volumes had fallen by 1.1% in June after having risen by 1.8% in May. Clothing and footwear sales volumes had fallen by 6.7% in June. Quarterly growth in retail sales volumes had slowed in Q2 to 0.3% from 1.0% in Q1, the lowest rate since 1995 Q3. This indicated a continued slowdown in spending, though it was perhaps exaggerated in Q2 by the impact of the weather on sales. The slowdown had been particularly evident in household goods sales. Annual growth was 4.4% in 1998 Q2. The growth in household good sales volumes had fallen sharply in the late 1980s prior to the peak of the cycle.

A24. Car registrations had fallen in June to stand 2% higher in Q2 than a year earlier. Private registrations had fallen by 0.7% in this period following strong growth in 1998 Q1. This was likely to depress growth in consumer spending in Q2. But the Bank’s regional Agents had suggested that in most parts of the country car sales in July had improved, and orders were up for August.

A25. Recent housing market data also supported a picture of slowing domestic demand growth. There was a close correlation between growth in consumption and housing wealth, though it was not

clear whether the housing market was a leading or contemporaneous indicator of demand. Both were likely to be related to income expectations. Housing transactions also tended to rise sharply when existing home-owners trade-up as incomes and prices rise. House price inflation did not appear to be rising. The Nationwide index had risen by 1.1% in July bringing the annual rate of increase down to 10.8%. The Halifax index had risen by 6.0% over the year to July 1998. The Bank index had increased by 8.7% in the year to 1998 Q1. Regional house price data had suggested some slowdown in the south-east of England in 1998 Q2 but little overall change in the regional pattern. The volume of transactions measured by particulars delivered were 5.9% lower in June 1998 than a year earlier. This apparent softening in the housing market was consistent with a slowdown in the growth of consumption, though it was not clear whether it would itself reduce consumption growth further.

A26. Housing starts had fallen by 10.9% in Q2 over Q1. Construction had fallen by 4% in Q2. More generally, investment might fall in Q2 in the absence of the erratic factors evident in Q1.

A27. The Public Sector Net Cash Requirement outturn in June was £6.1 billion, higher than June 1997, partly due to the timing of interest payments. Over the latest three months, the PSNCR was £2.8 billion lower than the same period in 1997.

A28. Monthly goods and services trade data had suggested that net trade may make a smaller negative contribution to GDP growth in Q2 than in Q1 (-0.7 percentage points). Goods export volumes had risen by 0.3% in May (excluding oil and erratics) reflecting a 1.8% rise in exports to EU countries. And exports to non-EU countries had risen by 3.6% in June, having fallen by 2.1% in May. Overall, exports to non-EU countries had fallen in Q2. The trend in total exports appeared to have been flat during 1998. Imports had fallen in May by 1.2%, but imports from non-EU countries had risen in June by 1.4%. The trade deficit deteriorated in May to £1.2 billion from £0.7 billion in April mainly due to oil and erratic trade with non-EU countries. This had unwound in the June data for non-EU trade. Excluding oil and erratics, the trade deficit was broadly unchanged between April and May.

A29. Survey data had shown a marked deterioration in sentiment over the latest month. Consumer confidence had fallen sharply in the June MORI survey: from +1 to -19. And it had fallen for the second consecutive month in the GFK survey in July, down 4.2 percentage points to -1.6%. This had been mainly due to worsening perceptions about unemployment. There had been no further fall in the balance of respondents believing that it was a good time to make a major purchase. The CBI Quarterly Industrial Trends survey recorded a large fall in the new orders balance: +2 in April to -17 in July, the lowest balance since October 1992 and the largest quarterly fall since July 1990. The balance of firms reporting order books above normal had fallen from -9 in April to -31 in July, the lowest balance since 1993 and the largest quarterly drop since 1980. The deterioration had been

mainly in domestic orders: -15 from +9 in April. Alongside the fall in orders, manufacturers confidence fell from a balance of -22 in April to -44 in July, the lowest since January 1991. Output balances had also fallen though less markedly. The reported output balance (past four months) had fallen from +7 to -4, the lowest balance since April 1993; expected output (next four months) had fallen to -8, the lowest since July 1991.

A30. The British Chambers of Commerce (BCC) Survey had also recorded falling balances for manufacturing orders and deliveries. Domestic orders fell from +12 in Q1 to +2 in Q2; export orders from -12 to -24. Domestic deliveries fell from +15 to +3; and export deliveries from -5 to -13. Investment, confidence and cashflow balance had all fallen to their lowest levels since late 1992. The July CIPS survey had showed a large fall in the manufacturing output index, from 48.7 to 43.2, the lowest level and largest fall recorded by the survey.

A31. On the services side, the BCC survey had indicated some slowdown in domestic demand, the home orders balance falling from 30 to 23, approaching its average level over the course of this recovery (+21). Home deliveries had fallen from +36 to +31. The export deliveries balance had fallen from +10 to 0, though the export orders balance (+3) was little changed on Q1 (+4). The CIPS Report on Services had indicated continued but moderate growth in services activity. The Business Activity index was 55.9 in July but had fallen for the fifth consecutive month. The Volume of Outstanding Business index was 48.7, below 50 for the second month running, although the Incoming New Business index was still above 50 (53.7).

A32. Investment intentions balances in the manufacturing sector had fallen in both the CBI and BCC surveys to their lowest levels since 1991 and 1992 respectively. But services investment intentions had remained relatively strong in the BCC surveys and well above the recent average.

A33. On the international side. Japanese industrial production had fallen again in June, by 2%; and retail sales were 0.9% lower in May than a year earlier. There had been some recent signs of stabilisation in Asia, but weakness in Japan continued to risk global imbalances and potentially threaten the outlook for China. Furthermore, financial risks and fear of contagion had probably increased over the latest quarter, notably in Russia.

A34. In the second quarter, US retail sales volumes had risen by as much as in Q1, and the inventory/sales ratio had remained historically low. US industrial production rose by 0.6% in Q2, but the annual rate of growth had slowed. The trade deficit had widened further in April, and the June National Association of Purchasing Managers survey had shown a fall in export orders. GDP

growth had nevertheless slowed in Q2 (0.4% on Q1), reflecting negative contributions from stockbuilding and net trade as well as the effects of the strike at General Motors. Domestic demand had remained strong, but was expected to slow gradually in the second half of 1998.

A35. Monthly data had suggested relatively strong GDP growth in Q2 in France and Italy, but a weaker picture in Germany.

III Labour market

A36. LFS employment grew by 36,000 (0.1%) in the three months ending in May, compared with the previous three months. This was similar to the increase recorded in the three months ending in February. The increase in employment in March-May, compared with the same months a year earlier, was 282,000, a much faster average quarterly rate than the latest three months. The employment rise in the latest three months had been entirely accounted for by part-time workers. A wider measure of labour demand, total hours worked, had increased by 0.3% in the three months to May. Though the series was volatile, it seemed that the trend may have flattened.

A37. Surveys of employment intentions had given a mixed picture of prospects. The CBI and CIPS surveys suggested falling employment in the manufacturing sector at an increasing rate. But the BCC survey suggested slowing, although still positive, growth in demand for labour in that sector. BCC service sector recruitment intentions showed a balance of 22% of firms expecting to recruit more staff, some 10 points above the ten-year average, but lower than in recent quarters, after adjusting for seasonal variation. Information from the Bank's regional Agents confirmed the sectoral picture.

A38. LFS unemployment had been 54,000 lower in the three months to May than in the previous three months and the rate had fallen to 6.3% from 6.4%. The claimant-count measure of unemployment had risen 700 in June after a slightly larger increase in May. But the claimant rate had remained at 4.8%. The difference in unemployment changes on these two measures could have reflected job seekers who are not eligible to claim benefit either finding work or giving up looking. The LFS survey suggested that unemployment falls during the past six months had been matched arithmetically by rises in numbers of people not actively seeking work, and the rises in employment matched the increase in the population of working age (though of course this did not imply that none of the previously unemployed people found work nor that all of the increase in population went into employment).

A39. Regional data showed clear regional differences in the extent of tightness, and recent analysis by the Employment Policy Institute showed marked differences within regions. But there was little variation in the recent trends in claimant-count unemployment at the regional level.

A40. The stock of vacancies had risen again in June and notifications had bounced back, but there had been a slowdown in the growth of press recruitment advertising in recent months. The latest CBI survey had shown a fall in the balance of manufacturing firms reporting skilled labour as a constraint on output to 12%, almost down to its long-run average. But the BCC survey for 1998 Q2 suggested recruitment difficulties in manufacturing and the service sector were at record levels.

A41. Headline whole-economy earnings growth in the three months centred on April was 5.4% compared with a year earlier, up from a revised 5.3% in March. That rise reflected a 0.1 percentage point increase in both manufacturing and services earnings growth. The difference between private and public sector earnings growth remained wide - annual growth had risen to 6.2% in the private sector and risen to 2.8% in the public sector. The ONS estimate of the contribution of irregular bonuses and profit-related payments to earnings growth allowed calculation of growth in the 'regular pay' component. High irregular bonus payments had continued to push up earnings growth this year but the ONS estimates suggested that of the 1.1 percentage point increase in twelve-month earnings growth between May 1997 and May 1998, regular pay accounted for around 0.9 percentage points of the rise.

A42. Twelve-month averages of wage settlements had continued to rise steadily during the second quarter as settlements in the current round were generally higher than in the previous one: the twelve-month employment weighted mean of settlements for the whole economy had been 3.8% in June. The increase in the second quarter was entirely due to higher private settlements (which included the second tranche of the construction sector settlement); public sector settlements had remained unchanged at 3.2% between April and June. Staff calculations of wage drift (the difference between earnings growth and settlements levels) showed drift had been rising since 1996. But it was still only around its long-run historical average despite recent high bonuses.

A43. The latest ONS data showed unit wage costs in manufacturing rising at around 6% with productivity lower than a year earlier. Agents' contacts continued to suggest that productivity growth was stronger than the official data. The London Business School (LBS) had recently published a study suggesting that the sectoral composition of productivity growth had been mismeasured. Bank staff had previously drawn the Committee's attention to the contrast between official data for manufacturing output and survey evidence, and to the weak official data for productivity; the LBS suggested that there was also a statistical break in the relationship between manufacturing employment data and survey data. The LBS economists did not, however, question the whole-economy data for earnings, productivity and unit wage costs; in their view an underestimate of manufacturing productivity growth was compensated by an overestimate in the non-manufacturing sector.

A44. In July, the Agents conducted a special inquiry into the potential effects of the Minimum Wage on firms. The survey covered 136 firms, employing around one million staff. A third of all firms said they would be unaffected. Because these firms tended to be the largest firms they represented 70% of the staff covered by the survey. Of those affected around a third had already taken action. Nearly half of the firms which would be affected said they would reduce margins. Around a third said they would raise prices and a third said they would reduce employment (firms were allowed to indicate more than one reaction). The survey suggested that service sector firms were more likely to try to increase prices or reduce margins, and manufacturing firms were more likely to reduce employment and increase mechanisation. Around 40% of firms affected said that restoration of pay differentials was likely to take place.

IV Prices

A45. Annual deflation in both commodity and manufacturers' input prices had persisted in June. The Bank's commodity price index had fallen (provisionally) by 1.6% in June, and by 11.3% over the year. The index excluding oil had fallen (provisionally) by 0.4% on the month and by 8.4% over the year. Metals and non-oil fuels prices had fallen since November 1997 as the turmoil in East Asia weakened demand; both had fallen by around 5% in the three months to June. Those falls had been counterbalanced by a provisional 5% rise in UK agriculture prices following recent bad weather and poor harvests. The sterling price of Brent crude oil (one-month future) had fallen by 8.1% in June and by a further 3.0% in July. The June oil price fall had contributed to a 0.7% fall in manufacturers' input prices, down by 3.7% on the year. The CIPS report on manufacturing had suggested a further fall in input prices in July.

A46. Oil prices had fallen since March 1997. That price weakness showed no sign of abating despite two OPEC agreements to cut supply in 1998. As a result, Saudi Arabia was proposing an alternative cartel of oil exporting countries to intervene in oil markets in order to stabilise prices. In July, the six-month future price of oil (£8.74) remained above the one-month future price (£7.88) reflecting high inventory levels and the consequent high price of storage.

A47. In June, manufacturing output prices (excluding excise duties) had recorded annual deflation for the third consecutive month; excluding excise duties, output prices had risen by 0.1% in June giving annual growth of -0.5%. The Quarterly CBI Industrial Trends Survey had reported a further fall in output price expectations in 1998 Q2 (the seasonally adjusted balance fell from -6% in Q1 to -10% in Q2). Though more volatile, the CBI expectations balance was correlated with annual producer output price inflation. The CBI balance of manufacturers' unit costs had remained negative, at -1.0%, in Q2; the balance had been close to its all-time low throughout the past year.

Low cost inflation could help to explain low output price inflation: but it was not consistent with the Bank's estimate of manufacturers' weighted costs which had continued to rise in Q2, by 0.8% year-on-year, due to rising bought-in services and unit labour costs.

A48. The tax wedge component in output prices had increased over the past year; annual output price inflation in June was 1.0%, compared to -0.5% for PPIY (output prices excluding excise duties). The increased tax wedge had been caused by rising petrol and tobacco duties and the weakness of petrol prices (which had a larger effect on PPIY than on total output prices).

A49. Total import prices had risen by 0.9% in May but had fallen by 3.5% on the year; total export prices had risen by 1.2% in May but had fallen by 2.7% on the year. Annual deflation had persisted in non-EU export and import prices in June (export prices down by 0.4% on the year, import prices down by 3.1%). Nonetheless, the correlation between falling trade prices and sterling's appreciation had not been as strong as expected, given past experience of exchange rate movements.

A50. The Bank's estimate of manufacturers' margins had been updated to include the food, drink, tobacco and petroleum industries. Following that change the estimates had continued to show a decline in margins on both domestic and export sales, as unit labour and bought-in services costs had risen, more than offsetting falls in other costs, alongside falling export and domestic prices.

A51. All of the main retail price inflation measures had fallen sharply in June following their surprising rise in May. The fall in annual RPIX inflation, to 2.8%, in June had been entirely due to goods prices, which had accounted for the rise in May. Annual RPIX goods price inflation had fallen from 2.6% in May to 2.0% in June; RPIX services inflation was unchanged at 3.1%. Within goods prices, the largest falls (relative to June 1997) came from seasonal foods, motor vehicles and petrol. Annual RPI inflation of 3.7% had remained above RPIX inflation because mortgage interest payments had risen 25% in the year to June. That gap between RPIX and RPI inflation was expected to narrow sharply in the coming months as last year's MIPS rises fall out of the annual inflation rate.

A52. RPIY inflation was 2.0% in June; the gap between RPIY and RPIX inflation was expected to narrow by 0.2 percentage points in July when the timing effects of recent increases in petrol excise duties fall out of the calculation. HICP inflation had fallen by 0.3 percentage points to 1.7% in June, in line with the fall in RPI inflation. UK HICP inflation remained above the average rate in the European Union of 1.6% in the year to May.

V Bank's regional Agencies: summary of business conditions

A53. A fairly widespread deceleration in manufacturing output had been reported, as difficult export markets and increasing import competition were accompanied by weakening domestic demand growth. Less regional divergence had been reported than previously, a slowdown in manufacturing being reported across the south of England as well as elsewhere in the United Kingdom. Housing market activity had also shown signs of slowing. Retail sales growth had weakened in all regions; softer consumer demand being attributed in part to concerns about mortgage payments. But in the rest of the service sector evidence of a slowdown had been more mixed, with some sectors (notably IT) reporting strong growth.

A54. No change had been reported in the scale of wage settlements or earnings growth; service sector contacts had continued to report higher settlements than those in manufacturing. Material input costs had continued to fall, reflecting the decline in world commodity prices. There had been some signs of a further weakening in manufacturing output prices and heavier retail discounting in response to subdued demand and a build-up of stocks.

A55. Reports of declining employment in manufacturing had increased. In contrast, reports of skills shortages had remained widespread in the service sector, although a few signs of softening had emerged; vacancies reports had not been quite as strong in recent weeks. The number of contacts reporting deferral of investment plans had risen, but much investment still remained in the pipeline — usually targeted at productivity improvements.

VI Financial markets

Foreign exchange

A56. July had been a quiet month for the G3 currencies on the whole. Sterling had softened against the Deutsche Mark, but had barely moved over the month against the dollar.

A57. The yen had weakened, to 107.4 on its effective index, with the main influence being the uncertain prospects for reform of the banking system and for permanent tax cuts. The yen's fall against the Deutsche Mark in the month had been steady; its path against the dollar had been more erratic.

A58. The Deutsche Mark had strengthened against both the yen and the dollar, to around Yen 81½ and DM1.77 respectively. With little change in European interest rates, the main factor behind the Deutsche Mark's strength appeared to have been the more stable position in Russia, reducing

concerns about the impact on the German banking system. When the IMF package was initially announced on 13 July, the dollar fell by almost 2 pfennigs against the mark. Since then the dollar had trended lower and was close to the bottom of its recent trading range.

A59. The sterling ERI had fallen by 1.6% to 104.0 over the month. It fell by around 1% in the first half of the month, then recovered, before falling further after the CBI Quarterly Trends survey released on 28 July. Sterling had fallen by about 2½% against the Deutsche Mark to DM2.90, but remained almost unchanged against the dollar (trading just under \$1.64). Some of the factors which had caused the Deutsche Mark to appreciate against the dollar – namely the unwinding of safe haven flows related to Russia – had affected the pound as well. Three pieces of domestic news had also affected the pound: the RPIX data (sterling fell); the average earnings data (sterling rose); and the CBI survey (sterling fell).

A60. Overall, the foreign exchange market was now more convinced than a month ago that the UK economy was slowing; the market was also probably a little less pessimistic about events in Asia and Russia. Both of these factors had proved negative for sterling.

Bond and money markets

A61. Overall, July had been a quieter month for domestic markets after the unusually sharp movements during June.

A62. The short sterling futures market seemed to have experienced four surprises since the July MPC meeting: the MPC's decision not to raise rates, the RPI data, the average earnings data, and the CBI survey. Larger than normal turnover of short sterling contracts on those days corroborated the view that those days were characterised by significant market repositioning, though it was difficult to draw firm forward-looking conclusions from the flow data.

A63. Looking at the market's short-term views ahead of the August MPC, very few contacts thought that rates would change. Anecdote suggested that the market was clearly still nervous, though implied volatility, derived from the LIFFE option on short sterling futures contracts, had fallen after publication of the CBI survey. The two-week forward general collateral repo curve indicated that little change in the Bank's repo rate was expected.

A64. Over the month, gilt yields had moved down, by about 15 basis points at 10 years, and by rather more than US Treasuries and German Bunds. The government's spending announcements had had little initial impact on the gilt market, though subsequently some contacts had worried about the potential implications for gilt supply if the economy were to slow sharply.

Equity markets

A65. Overall the FT-SE All-Share index had fallen by 6%, to 2643, since the July MPC. Major markets fell sharply after Chairman Greenspan's Humphrey-Hawkins testimony on 21-22 July. There had been a small fall in long-term real yields during the month, so the change in equity prices probably reflected either a fall in profit expectations or a rise in the equity risk premium.

A66. Looking at sectors of the UK equity market showed that the *general industrials* sector had fallen by 11.5% since the last MPC; within this, *chemicals* fell by 15.0%, linked to the ICI profit warnings. Taking a longer perspective, the *chemicals* sector had underperformed relative to the All-Share since the start of 1996. Looking at revisions to analysts' forecasts for profits over the past three months showed that the recent underperformance in the *chemicals* sector was associated with a downward shift in profit expectations for 1998 and 1999.

A67. The *general retailers* index had increasingly underperformed the FT All-Share since the autumn of 1997. Analysts' earnings forecasts for this sector had been revised down for 1998 (but not for 1999) over the past three months.

A68. Analysis of profit warnings showed more warnings in July 1998 compared with July 1997. These were predominantly in the *general industrials* and *general retailers* sectors. (A profit warning had to be issued where a quoted company's directors became aware of information about their company's performance which was likely to lead to a substantial movement in its share price. Profit warnings were therefore an indication of genuine news about a company's prospects, and possibly about the sectors in which the company operated.)

A69. Separately, Bank staff had looked at the effect of news on the minimum wage on the share prices of listed (ie relatively large) firms. Five sub-sectors of the FT-SE All-Share index had been selected which corresponded to the industries identified by the Low Pay Commission as having a high proportion of low paid workers; *household goods and textiles*, *retailers (food)*, *retailers (general)*, *leisure and hotels*, and *breweries, pubs and restaurants*. The analysis showed that these sub-sectors had not responded significantly to news items about the minimum wage over the past three years. However, the analysis did not necessarily carry over to small firms.