12A40/18

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 JANUARY 1999

Present:

Mr George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Stability
Dame Sheila Masters, Chairman, Sub-Committee of Directors
Mr Allsopp
Mr Bailie
Mr Buxton
Sir David Cooksey
Mr Davies
Mr Hawker
Mrs Heaton
Sir Chips Keswick
Sir David Lees
Ms McKechnie
Mr Morris
Mr Neill
Sir Neville Simms
Sir Colin Southgate
Mr Stretton

On behalf of Court, the Governor congratulated Mr Hawker on his CBE, in recognition of his contribution to industry in Wales, reported in the New Year's Honours List.

The Minutes of the Court of 16 December, having been circulated, were approved.

MONETARY STABILITY ISSUES

Economic and Monetary discussion, incorporating the monthly MPC Report to Court (Messrs Vickers and Plenderleith together with Sir Alan Budd, Professors Buiter and Goodhart and Dr Julius in attendance)

Introducing the discussion, Mr Vickers drew Court's attention to the minutes of the December and January meetings of the Monetary Policy Committee and to the votes of the members. He noted that in January, Mr Plenderleith voted for no change and Dr Julius voted for a greater reduction than the ¼% agreed. Mr Vickers also drew Court's attention to the data on third quarter GDP, the labour market, retail prices and retail sales. He said it would be helpful to hear the views of members of Court on why consumer spending was weak, whether there had been a pick-up in business and consumer sentiment and particularly whether upward pressure on pay growth was easing. The Governor noted that the Agents' special enquiry in January was into pay growth.

Turning to the markets, Mr Plenderleith said that the conversion to the euro had gone extremely smoothly and the bout of selling of sterling that some had feared at the end of the year did not materialise, since most people had squared their positions in advance. He noted a puzzle in Japanese markets with a stronger yen, a sharp rise in bond yields and a relatively weak equity market. He also noted that the other main equity markets had started strongly but there had been gyrations as a result of the news in Brazil. In general, equity markets had recovered and were at similar levels to last year.

Sir Chips Keswick commented that the Agents' concern at trends in the house building sector may have been a result of hearing special pleadings. His direct experience was that the business carried forward from December was at least 10% up on last year, and the first weeks in January were a record. Mr Neill said that car sales in the first 10 days of January were 31% lower than a year earlier, though this included one fewer reporting day. This news confirmed the slowdown he had expected in December. The industry was forecasting an 8% decline for the full year. Mr Morris said he agreed with Mr Neill's assessment of car manufacturing. Turning to wage settlements, he said his Union's experience, so far, had been that there was a degree of stability, with settlements in the range of 3% to 3½ %. That represented a normal tailing off at the end of the year, and the real interest was in the next round of settlements. This included the local Government settlement and discussion on the restructuring of pay in the National Health Service. He suspected that 1999 might begin to show some rises, because in certain sectors, such as nursing and teaching, good quality staff were moving around. The first two quarters of 1999 would be worth watching. He also noted that private sector settlements had been very stable, at about 3%.

Mr Buxton said that the main change he had seen was that domestic orders were falling, and this would probably be borne out by the CBI survey the following week. The impact was spreading to the retail market, where a downturn in the rate of lending growth was just starting, though the rate of growth was still quite fast. Mr Buxton also noted that domestic order books were falling faster than they had been, and a slowing of the downturn in exports was not enough to offset the downturn in domestic orders.

Sir David Lees said that on a visit to the Birmingham Agency earlier in the week he had been very impressed by the way the Agent skilfully drew out the views of his guests at lunch. Sir Neville Simms noted that each new forecast in the construction industry showed a fall on the previous one. He also noted that there were still quite considerable pay pressures in the Midlands and the South, but in the North these were virtually irrelevant. Turning to labour costs, he noted the change from self-employment to direct employment forced on the industry by the Inland Revenue. This put employers' administration costs up, and also lead to upward pressures on wage demands. He also noted that the effect of the Working Time Directive would be to add 2 to 3% to construction industry wages because the industry did not pay for holidays and the Working Time Directive made this necessary. He noted that the industry would still be reasonably buoyant in 1999. There were opportunities for earnings increases through productivity related schemes and certain skills were in considerable shortage and pay for those skills was rising.

Dame Sheila Masters noted that the insolvency partners at her firm were very busy. Mr Buxton noted a rise in the number of companies being cared for in the banks' "hospital wards", particularly smaller businesses, but it was not particularly significant. He expressed surprise that the accountants were so busy at the moment. Mr Bailie noted the contradictions between the reality of what was happening at the moment and much lower confidence for the future. The Governor said he was in very good company in finding this confusing. Sir David Cooksey noted that in the clothing industry in December, despite massive sales, volumes had fallen 15% on last year and the multiples, particularly Marks & Spencer, were the main sufferers. Volumes in January were down further. The industry would lose many jobs in the UK.

Sir Colin Southgate noted that recruitment, for middle management upwards, was well down in the last quarter, according to head hunters. He noted that in a number of countries in the Far East the economy was depressed, and it would take some time for them to come out of it. In Japan, he did not see an improvement. The developments in Brazil had been expected, and throughout last year there had been an increase in his company's bad debt position there. In Europe, the German consumer market was still weak, but France was improving, while smaller countries had been in a better position for some time. In the UK, the music market had improved in January, as usual, but the book market was flat. On the wages front, he saw no particular pressure, except in demands from unique artists. Overall, Sir Colin commented that the market was very weak. Mr Hawker said he agreed with Miss Camper, the Agent for Wales, that the signals were noisy. He also noted that a problem for Wales arose from its dependence on inward investments.

Mr King commented on the rise in RPIX from 2.5% to 2.6%. He noted that the probability that the Bank could keep inflation within such a narrow range was negligible, since there would be shocks. There had been great stability for six months, but this created a problem in public perceptions for the future. In reply to a question from Sir Colin Southgate about the Harmonised Index of Consumer Prices, Mr King commented that it took no account of housing costs, and statisticians at a European level wished to change it to take account of that. The absence of housing costs accounted for about half of the difference between RPIX and the HICP. Professor Buiter commented that the index had not been available very long, so little was known about its statistical properties, and it was not yet a very good index. He hoped there would be no switch to the harmonised index before that issue was addressed. The Governor noted that the Chancellor had laid to rest the issue of introducing the index as a target for the MPC in his appearance the day before at the House of Lords Committee on the Monetary Policy Committee. Some of those who had been pressing for a change to the harmonised index as a target thought of it as a backdoor way of easing monetary policy.

MPC Procedures (Messrs Vickers, Plenderleith and Footman together with Sir Alan Budd, Professors Buiter and Goodhart and Dr Julius in attendance)

With reference to a Minute of 16 December 1998, Mr King, in introducing the third discussion of MPC procedures, said that the paper before Court focused on the quality and relevance of the preparatory work produced by Bank of England staff to assist the MPC in its decision making process.

Mr Allsopp said that in writing the paper he had taken his brief to be to look at the economics department of the Bank and how it fitted in with the MPC process. He did not believe it right to canvass the view of the main client, the MPC itself. He noted that the pre–MPC meetings were large and had a large resource impact, so there were resource allocation questions. If more had to be done in one area less may have to be done in another. He noted that the economics department was of the best standard that could be expected and it had also been flexible in its responses to the demands put on it in the last two years. He believed the balance between proactive pushing of economic views, against responding to demands put on the department by the MPC, was about right. His paper also tackled some potentially more contentious issues relating to what happened after the pre–MPC, and to the Inflation Report. The Fan Charts were the best collective judgement of the MPC, and whilst the Inflation Report had not so far had to include a minority forecast, it was perfectly possible that such a situation might arise. He commented that the Bank had quite rightly tried to use small forecasting models, and he noted that the core model was quite small and was also domestic, without international linkages. The model had built into it the perception that in the long run there was no trade-off between inflation and output and unemployment, but also that in the short run there were trade-offs. The model was under development all the time and Mr Allsopp noted that the Bank was committed to publish the model and to publish others from its suite of models. Mr Allsopp also drew attention to the fact that there were judgmental inputs to the forecasting process, because forecasting was very far from a mechanical process. He noted the possibility that the suite of models could be quite contentious when it was published, and he also drew attention to the fact that other work was underway in the Bank for the Treasury Committee, describing the MPC's view of the transmission mechanism. When the models were published, journalists would be able to pick out roughly what the Bank thought about, for example, the impact of raising interest rates 1% and what that would do to inflation two years ahead, and also the degree to which the transmission mechanism worked through unemployment. He noted that a possible response to any misunderstandings on these issues, would be to say that there was an extensive research programme on the issues within the Bank.

Mr Allsopp said his paper commented favourably on the establishment of the new international division in Monetary Analysis in March 1999. This was an example of how the economics department responded to change.

He noted that there was still a question about whether Court should talk in more detail to the client, the MPC. But in general, he said the Bank had a relatively small economics department which worked very hard, and which in his view was of very high quality.

Dame Sheila Masters noted that all the members of the MPC were at the Court meeting and she asked whether any of them wished to give their views. Sir Alan Budd commented that Mr Allsopp's paper was excellent. He fully endorsed the comments on the quality of the staff, which was absolutely outstanding and as a former Treasury official he looked enviously at their quality and dedication. Turning to the process, he said that the issue of responsiveness was up to the MPC. Discussions were still taking place on the pre–MPC meeting, and the members' views had been sought, and there might be change. He spoke as a highly satisfied customer, however.

Professor Buiter agreed that the quality of the staff was outstanding and he had never seen a collection of people so professionally competent and dedicated, who worked unbelievably hard. However, the amount of work imposed on the staff was a problem. He did not believe that Monetary Analysis had enough human resources for the monthly round, the Inflation Report and the special topics while leaving these high quality 'applied scholars' some time for capital appreciation. He also commented that a rethink was required of some of the processes, and this needed to be accelerated. There should be considerable reorganisation of the pre–MPC meeting, which was not selective enough. He also believed that the format of the Inflation Report should be rethought as well. For example, it did not make sense to have a constant interest rate forecast. Professor Buiter believed that there should also be a major effort to further develop the models. The core model was very much "under development", and needed further resources urgently. The speed with which it could be done depended on the resources allocated to it.

Professor Goodhart said he agreed with Professor Buiter rather than with Sir Alan Budd about the sufficiency of resources. For the last two years, staff had not had enough time to do the research that they should have been doing to provide background for ongoing work on conjunctural analysis in support of the MPC. He commented that compared with its counterparts in Canada, the US, Germany and Italy, the Bank of England ran a very tight ship indeed. He believed that the staff were being unduly stretched in this area. He also noted that the inflation forecast was by the MPC as a whole, so the members became part of the forecasting process. Mr Allsopp had talked about the monthly round, but that was very limited compared to the work in the forecasting round where the number of meetings multiplied by three or four. Because the forecast was by the MPC as a whole, the external members also got caught in that round. The external members could, as an alternative, have attached themselves to other forecasters, and have a separate forecast, but with the MPC as a whole they were in fact part of the Bank forecasting round. There were a lot of advantages, but the members were in a sense caught in the Bank process to an extent that may arouse concerns - for example – Lord Burns at the Select Committee of the House of Lords had wondered whether the members were going native.

Dr Julius said she agreed with the others in endorsing the high quality and dedication of the staff in Monetary Analysis. She agreed with Sir Alan that the number of people was probably appropriate in a cost effective sense and she also endorsed the point made about their responsiveness to specific queries in the short term. What was more important in the long term was to ensure the allocation of the available staff resources reflected the priorities of the MPC as a whole. There were many things members would like to do but in the real world choices had to be made, and it was important that all members were involved in discussions of allocation of staff across divisions and longer term research priorities. Since the MPC devoted a large part of its time and effort to forecasting, so did the staff. An implication was that despite having, to some extent, a suite of models, there was a disproportionate focus on a particular forecasting model. She would like to see some work done on alternative ways of looking at future inflationary pressures using alternative concepts such as leading indicators. But it was difficult to carve out staff time for this when so much was dedicated to forecasting.

In reply to a question from Mrs Heaton she agreed that a meeting to discuss prioritisation would be helpful, but she did not feel there should be dedicated research resources for individual members. In her view it was better to have a single research department in the Bank of England to which all members had equal access.

Mr Vickers noted that there were meetings to discuss prioritisation. He also said that the paper for Court was an extremely helpful contribution for the Monetary Analysis department as well. He was pleased at the new international division within Monetary Analysis, but he said that lots of international work had been going on in the department and this was a case of stepping up the profile. International work also spanned the Bank, he said. Turning to the balance of resources between the monthly meetings and the quarterly Inflation Report and the Bank's research efforts, Mr Vickers said that this issue much exercised him. The MPC was a huge demand on resources. A meeting had taken place towards the end of last year about the research process. The responsibility for executing research was with Heads of Divisions but all MPC members were very much involved in the research process. His intention was that the MPC should be involved in setting the research agenda. Turning to the models and the forecast, he said that there was a big push underway in that area, and he also noted that tutorials had been offered to MPC members explaining the models. The MPC members themselves were a very important resource, and he did all he could to lure them into research projects, and all of them were involved in that sort of work.

Professor Buiter agreed that external members had been invited to participate in discussions of the research agenda. However, it was difficult to separate the agenda from the organisation of what was agreed. He had requested since he came to the Bank access from his computer, in a user friendly form, to the models. That had not happened. It might happen soon but it should have been the day he walked into the Bank.

Sir David Lees said that NedCo would need to be clear that silence from the internal members of the MPC would imply that they were satisfied with the procedures. He also said he had never known anybody who did not have to pay for resources not to want more. Only when an answer had been obtained to the question of whether resources were being used appropriately should consideration be given to whether there should be more. He commented that the Bank should also be seeking to benchmark its resources in comparison with other Central Banks. Turning to the Inflation Report question, he said the MPC signed the report collectively but when it came to judgements on monetary policy there were independent views, and it may be that addressed any differences, so there was no need for a minority report. Sir David Cooksey asked what processes where in place to review MPC performance. The Governor asked whether Sir David was referring to procedures or to assessing the outcome of policy decisions. He noted that discussion at Court was about procedures of the MPC, which were a NedCo responsibility. The question of procedures and resources for assessing outcomes of policy decisions was for the future. In response to Sir David Lees' question about the views of executive members of the MPC, the Governor said that if they had detected problems in the processes they would have changed them.

Ms McKechnie said she regretted that the discussion had not addressed the concern in the Allsopp paper of how the Bank's models would be received. There seemed to be a serious concern in the paper that somehow the credibility of the process could be undermined. Dame Sheila said that Mr Allsopp had noted with approval the increase in transparency, including the publication of the model. It was a healthy move, which Court supported, that the model should be published. She had read Mr Allsopp's paper as being positive on that point rather than negative. The Governor agreed.

Sir Alan Budd sympathised with Professor Goodhart and Professor Buiter. But on the question of whether there was a house view he was not conscious of one. People leant over backwards not to present a house view. Nor did he think that there was an issue of 'going native', though it was always worth asking that question. Turning to the concerns about publication of the model, he said it would reveal the quality of the model which might be embarrassing, but if it were, then the Bank should be embarrassed. He also noted that publication would allow people to second guess what the Bank of

England would do next. The only comfort he could give on that was that the Treasury model had been published every year since 1975. The ITEM Club used the Treasury model to predict the consequences of Treasury actions, but this had caused very little ripple or concern. He, personally, was not concerned about publication of the Bank models, particularly if it was emphasised that they were part of a suite.

The Governor commented, in concluding the discussion of MPC processes, that if there were a danger of institutional capture, Court had had a demonstration during the morning's discussion that this was not a very real risk.

Executive Report

Mr King noted that meetings of the Monetary Policy Committee had been taped. The intention was to destroy the tapes after the minutes had been published. A question had been raised of keeping the tapes for posterity. The Committee had, however, decided to erase them. The evidence from the United States, where tapes were available of Federal Open Market Committee meetings, was that almost no use had been made of them by academics and researchers. But the fact that the tapes existed had changed the nature of the meetings, because people came with prepared statements. If this occurred at the Monetary Policy Committee it would undermine the nature of its meetings. No members came into the MPC meetings with their minds made up completely, and the tapes would undermine that advantage. The MPC's intention was to erase the tapes unless Court expressed wishes to the contrary. The MPC did, of course, publish fuller proceedings than any other central bank. Court was content.

FINANCIAL STABILITY ISSUES

Developments in International Markets (Messrs Clark, Plenderleith and Vickers in attendance)

Mr Plenderleith reported that the major development was the deterioration in Brazil, where the exchange rate had not been maintained and its depreciation had undermined the framework of the Brazilian economic programme. It remained to be seen what the new policy framework would be. There were some signs for hope that the shock of events in Brazil would not be as great as with Russia and the contagion effects not as serious. This was in fact because the markets had been concerned that the Brazilian programme might not be sustainable and there was some relief that the worst was now known. This lay behind the rather puzzling positive reaction of the major stock markets. He noted that there were still some very real risks, and a number of question marks over the international policy prescriptions of the IMF as a result of the Brazil case.

Noting the risk of contagion, Mr Clark said the outcome hung crucially on whether Brazil could re-establish an anchor for its economy. If the exchange rate were free to fall without limit, there was a risk that contagion would re-emerge.

Sir Chips Keswick commented that five times in 12 months the IMF had failed. He urged the Bank not to fall too closely behind the IMF, because it never got it right. Mr Buxton commented that the big risk in the UK economy was international not domestic. The Governor agreed that the situation was uncomfortable.

FINANCIAL MARKET OPERATIONS ISSUES

Conversion weekend and the introduction of the Euro (Messrs Clark, Plenderleith and Vickers in attendance)

Commenting on the conversion weekend, Mr Clementi said the Bank had been involved for two to three years, internally with a team of 300 under Mr Plenderleith to ensure that Bank systems and links to other systems could cope; and externally with a team under Mr Townend which had prepared the Practical Issues quarterly, had undertaken road shows and conferences about the readiness of London, and had co-ordinated the efforts of the major City firms, numbering about 45. Taking the two sides together, the weekend had worked extremely well, and from London's point of view had gone ahead almost without a hitch. Central to the effort were the payment systems. It was gratifying to report that a huge amount of business was being done each day on Target in both directions, and London was involved in about a quarter of the trades. It was already apparent that London had a major role in Europe, but it was difficult to predict the long term competitive position. He commented that the competition between Eurolibor and Euribor did not in general matter for London, though it did have significance for Liffe. The good news on that was that Liffe was working very hard to deal with the problem. Mr Buxton noted that in the City there was widespread admiration for the role in the conversion process of the Bank of England, and Court should be aware of that.

Issue of Euro Bills

Mr Plenderleith presented a paper describing the previous week's announcement that the Bank proposed to issue euro denominated Bills. He said that the risk implications were no different from those of the alternative funding that the Bank had already put in place. But it would be somewhat more profitable. It would also be the first time the Bank of England had sold marketable paper under its own name since the 18th Century, with the possible exception of the issuing of its own shares. The Governor noted that he was sure that the Audit Committee would wish to look at the risk characteristics of the Bill programme. Sir David Lees noted that there had been informal discussions, and the proposal seemed to give rise to no problem. Commenting on paragraph 11 of Mr Plenderleith's paper, he suggested that the words "all within the established risk control processes" should be added to item iv. Court was invited to agree to

(i) the issuance of Bank of England Euro Bills of up to one year maturity,

(ii) a maximum amount outstanding with the public at any one time of €5 bn,

(iii) and additional amounts of up to €0.5 bn on the Bank's own balance sheet to be lent to market makers in sale-and-repurchase operations, and

(iv) use of Bank of England Euro Bills as collateral in the Bank's sterling open market operations and as intra-day liquidity within sterling CHAPS, all within the established risk control processes.

The Governor asked whether Court was content to agree, with the addition of the phrase proposed by Sir David Lees. Court was content.

MANAGEMENT OF THE BANK

Quarterly Financial Report (Messrs Midgley, Clark, Plenderleith and Vickers in attendance)

Mr Midgley said that at this stage of the year his focus was more on the expected out turn for the year, in other words what it was intended to spend in the remainder of the year, rather than what had already been spent. He drew Court's attention to the figures for the estimated out turn for the year in tables A2 – for components of profit or loss – and A4 - for components of expenditure. Mr Midgley said that total spending was forecast to be close to budget for the year as a whole. The budget assumed an earlier transfer to the Financial Services Authority than was actually the case, so the fact that the Bank now expected to be close to budget indicated an underlying under spend of about £3mn for the year as a whole. The actual under spend to date in the first three quarters was, however, about £8.5mn, and close to £12mn in underlying terms, excluding supervision and surveillance. So there was a big turnaround projected in the fourth quarter.

Timings were part of the explanation, but not all. Mr Midgley said he did not think it was a result of areas setting out to spend up to budget in a Christmas spending spree, because that was not the behaviour that had been observed in previous years at the Bank. He believed the explanation was that the quality of some of the estimates was not as good as they could be, so his best guess was that there would be some turn round in the fourth quarter, but that the Bank would under spend in the year as a whole.

In reply to a question from Dame Sheila Masters, Mr Midgley said that bonuses were only included where they were contractual. He agreed with Dame Sheila that the budget assumption was that bonuses did not need to be paid. Dame Sheila noted that underspending was not necessarily good and Mr Clementi agreed that this was the case in a central bank, and indeed on occasions in commercial organisations. It would be part of the review that the Bank would carry out with Court over the next few months. Dame Sheila commented that she would have liked to see the implications drawn out. Mr Vickers noted that in his part of the Bank underspending was mainly to do with restructuring and retention issues.

Services Bargaining Unit Ballot (Messrs Footman and Matheson in attendance)

Mr Footman reported that there were 300 people in this unit, including the security force, the chauffeurs, the sports club staff, services staff and the gatekeepers. Numbers had fallen and with the move to a single building would fall further, but the need for redundancies would be reduced if the staff in the unit could work more flexibly. The Bank had offered an hours-based contract in which staff would turn up at the time they were wanted. Substantial bonuses and increases in salary of between 2 and 20% had been offered, depending on change of working practice, in addition to 2¼% across-the-board. There had been tension over this issue over the New Year, and it was particularly sensitive for the security force of about 100 staff, who were concered about the Bank's readiness to recruit gatekeepers into security. The ballot had rejected the management proposals. Management had now taken the offer off the table, and now proposed to deal with them group by group, as a management issue. The next flash point would be the pay negotiations for this Bargaining Unit in July, but there was likely to be a series of mini flash points as the Bank dealt with individual groups within the 300 staff. In reply to a question from Mr Neill, Mr Matheson said that it had been a BIFU consultative ballot and the union had designed the question which he considered had been worded appropriately given that BIFU had adopted a neutral stance. Mr Neill said that multi–skilling should not be negotiable and the same applied to certain types of working practice. He would support management in being very firm about this.

Mr Footman said the Bank had sent a signal by taking the offer off the table. Staff had been told that new arrangements would not be imposed, though it would have been possible to do so and in fact the Bank would have been fully within its rights to dismiss the staff and offer new contracts. But it was felt that the Bank could probably do better, given the split among the staff, by tackling the issues case by case over the next six months. In response to a question from Mr Morris about whether the Bank was confident that the second approach would attain the same objectives, Mr Midgley said that management was reasonably confident and there was a large set of alternatives that it could follow. He noted the possibility of compulsory redundancies. In response to a question from Mr Buxton, Mr Matheson said that the Bank had a redundancy procedure agreement, drawn up in the 1970s, and had been working to that. It did not preclude compulsory redundancies. Mr Bailie expressed his support for the general approach. Mr Davies said Court should support it strongly. There had been a new management approach in the Bank over the last five years or so, and some areas had slimmed down and others were under a lot of pressure. There was a serious downside in relation to the rest of the staff if areas of the Bank which operated in a different way were left untouched. People were conscious of this underpinning of inefficiency and would like to get rid of it.

Mr Footman's paper on the Annual Report 1998/9 (Messrs Footman, Clark, Plenderleith, Vickers, Berkowitz and Midgley in attendance)

Before inviting Mr Footman to introduce his paper, the Governor pointed out that this year's Annual Report would be the first to contain a formal review by NedCo of the Bank's performance against the objectives and strategy set for the year. He added that the statutory framework for such reporting had not been established when the objectives and strategy had been set, but for the purposes of this exercise, it was necessary to recast these as if they had been. Whilst the paper before Court for discussion indicated that the review in the Annual Report could be undertaken in two ways, the Governor suggested that Court might wish to consider whether it would be more practical to present the review as a paper produced by the Executive, with a short accompanying paper from NedCo.

Dame Sheila said that Mr Berkowitz had advised that the review could be presented either way. The Act appeared to imply that the Non–Executive Directors should be doing the review but NedCo had agreed that in relation to monetary policy the substantive description of the procedures would be by the Bank. The question was therefore whether a different treatment was wanted for the rest of the Bank. Mr Footman had suggested that it might be adversarial to do it in that way. She believed it was more adversarial to have the content authored by NedCo, not by the Bank itself.

Sir Neville Simms commented that it was important that NedCo behaved with a light touch. Dame Sheila noted that Court had been invited to take the objectives in the Annual Report as the basis of the current year's discussion, though these would be modified for the next year. There was an issue of whether those objectives should have been re – phrased after the Bill came into force on 1 June 1998. But in practice Court would now have considerable editorial liberty when describing the Annual Report objectives for the current review. This applied particularly in relation to the financial management objectives.

Sir David Lees, commenting on page 6 of the paper, proposed that there should be a Remuneration Committee report in the accounts. Good practice suggested that it should be covered in that way, and not as part of the notes to the accounts. That was the view of the Audit Committee when it last met in quorate form. The Governor said he took the point.

Report from the Chairman of the Audit Committee

Sir David Lees, said that he had learnt the night before that the Audit Committee meeting on 14 December was not quorate. Given the time constraints and the fact that it was not quorate he hoped that it would be possible to find some way of making the conclusions of the meeting quorate at the next meeting. The Governor said that the Bank would try very hard to organise the timing of the Audit Committee meetings around the timing of Court meetings. Sir Neville Simms said it was his fault that there had been no quorum because he had been unable to attend at the last minute because of urgent business. The Governor thanked Sir David and the members of the Audit Committee.

Court rose.

Sheila V Masters
17/2/99

Peter Rodgers
17/2/99

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 FEBRUARY 1999

Present:

Mr George, Governor

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Stability

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Mr Davies

Mr Hawker

Mrs Heaton

Sir Chips Keswick

Sir David Lees

Ms McKechnie

Mr Morris

Mr Neill

Sir Neville Simms

Sir Colin Southgate

Mr Stretton

The Minutes of the Court of 20 January, having been circulated, were approved.

MONETARY STABILITY ISSUES

Inflation Report, together with the economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Vickers, Plenderleith, Jenkinson and Professor Buiter in attendance)

Mr Vickers drew Court's attention to the Inflation Report, the minutes of the MPC meeting in February, the interest rate cut earlier in the month and the market data which had just been published. He noted that, in the context of the Inflation Report, the news since the late summer was of a downward revision in projections for world GDP and trade growth and lower imported inflation. There was also a weakness in domestic demand, especially of consumer demand, signalled by surveys, and now showing through in official data. The assessment of domestic inflation pressure, particularly from the labour market, had led to a softer profile for earnings growth. Part of the benign picture was related to inflation expectations which had continued to ease over the last quarter. Mr Vickers noted that some members of the Committee thought that the inflation profile should be a little lower, and the reasons were given on page (iii) of the Inflation Report. He asked Members of Court for their views on prospects for consumer demand, the labour market, and productivity issues.

Mr Plenderleith noted that sterling had been remarkably steady despite substantially larger interest rate cuts in the UK than in other countries. He said he had no ready explanation other than seeing it as an indication of international confidence in the policy stance. He noted that the yen had weakened and bond yields had fallen a little, leading to unhelpful gyrations in Japanese markets. There was also a curious weakness in the euro which had been softening against the major currencies. It was partly because of a strong dollar and slowing growth in the euro area. He believed it was mainly a portfolio effect. There had been a substantial issuance of bonds in euros to establish a presence in the market and the proceeds had been switched out to other currencies without a countervailing adjustment in portfolios. He also noted the absence of repercussions from Brazil's problems as a result of a view that the current account effects would take longer to come through.

Mr Neill noted that in the first ten days of February the retail and business market for cars had fallen 25%. Within this, Volkswagen was up a little and BMW and Rover were down by around half. The market situation would lead to very substantial incentive bonuses for dealers. The market was also expected to deteriorate in the rest of February, by as much as 40%, partly because of the new registration period starting on 1 March. He expected the first quarter as a whole to be down between 5% and 10%.

Mr Bailie noted that a survey of printing and publishing industry wages had shown wage drift of 8.5% against very flat profits, but overtime was up 13.5% across the industry, even though companies were still claiming they were nowhere near capacity. He suggested that this might be as a result of a shift in purchasing to "just in time". Companies were working well below capacity, but there were some days when demands were very much higher which led to overtime work. It was a major problem for the industry.

Sir Neville Simms said that there were very clear signs that output was peaking in the construction industry, and so was employment, and it was only in London and the South East that there was any significant wage pressure. The only question was what was really going to happen about public expenditure. If policy were changed there could be a very much sharper decline. The Governor commented that given the latest public sector data, it should not be a shortage of money that stopped public spending.

Sir Chips Keswick commented that he did not expect to see much disturbance in currency markets until later in the year. Sterling was likely to remain strong because there was no speculation against it and it paid a higher interest rate. Mr Buxton said that in his business the strain indicators were gradually increasing. Receiverships were up, profit warnings were up in the last six months and in some sectors such as motor retailing the strains were beginning to show throughout the country. Textiles had been displaying problems for some time. It was quite patchy, but all the signs were of a steady decline. Barclays was forecasting zero growth in 1999, implying a technical recession at some stage. He did not believe that this would have a huge effect on the business because the industrial and personal sectors were in a much better position to face up to a downturn than in the past. He noted that the CBI survey had shown confidence had stabilised.

Mr Morris noted that the public sector was setting the pace on settlements and there was a very big debate about areas where the government was directly responsible for wage structures, such as the NHS and teachers. He agreed with the Governor that it was best generally for settlements to be paid in one go rather than staged.

In response to a question from Mr Allsopp about the factors lying behind the projection of a pick-up in activity later in the year, Mr Vickers said that it could be the result of several factors including public expenditure, reversal in weakening of consumer expenditure and a return to positive stock building.

Sir David Lees noted that Table L13 in the pre-MPC charts did not appear to be totally in line with the Agents' summaries. Mr Vickers noted that the Agents comments about wage drift were very much in line with those of Mr Bailie. For its part, the Bank was unclear about what was going on. He gave a health warning on the figures in the table, which he noted were measured productivity. It was possible that either or both manufacturing and services productivity were not measured ideally. Measured productivity growth had been rather weak over the period. Mr Jenkinson said there was a dilemma between what the Bank was told by its business contacts and the measured data. There had been very slow productivity growth in the official data, from manufacturing as well as in the economy as a whole, until the downturn through 1998. Employment in manufacturing had been relatively steady without much growth in output for some time. Professor Buiter said that this discrepancy should serve as a warning against casual acceptance of soft survey evidence. He had never met an employer who did not justify wage increases by productivity growth. Surveys were very useful, however, since they were biased in a way that could be accounted for.

Mr Neill said that the Government had put huge emphasis on the benefits of productivity improvements, and all the evidence showed that the UK lagged its competitors. He asked whether it was possible to monitor unit labour costs and productivity by sector. He also noted the impressive gains in productivity that resulted from internet technology and he praised the benefits that could be achieved by productivity forums. Sir David Cooksey said there was an unusual amount of investment in the IT sector partly as a result of the Year 2000, and while there were initial labour costs there would be productivity benefits later, so there may be a surge effect as the results of that particular type of investment come through. He also noted that retailers may have under-ordered in response to last year's high stocks and may compensate for that when they reorder. Sir Colin Southgate commented that the Agents reports may reflect the way savings in purchasing costs were added into companies' estimates of productivity gains. Mr Vickers commented that if that were true, and if the suppliers were in part foreign, the productivity figures would be unusually good. He noted that the McKinsey study of the productivity gap showed that it was much larger in output per hour than on the basis of all round estimates, which took into account the capital that people worked with. On measures of total factor productivity, the gap was less. In response to Mr Neill's question about publishing estimates of productivity by sector, Mr Vickers said that the data problems were quite severe. Labour costs were not very clear on an economy-wide basis and if disaggregated the data would not be "hard" on earnings or productivity. He noted Dr Julius' service sector study, with Nick Oulton. The Bank was doing what it could, but had to be realistic about how far it could push the data. It was an issue on which the Bank very much concentrated.

Work of the Agents (Messrs Vickers, Plenderleith, Jenkinson, Iles, Kemsley and Ms Hyde in attendance)

In introducing the annual report to Court, Mr Jenkinson said the reports discussed the role of the Agents in the monetary policy process, it included a note on links two Agents had with special investment funds, which Court had requested to be kept informed of because of possible risk to the Bank, and information on links between the Agents and the embryonic Regional Development agencies.

Mr Bailie commented that the work of the Agents was very important. They had an opportunity to talk to people on the ground and listen to local problems on the understanding, of course, that only a national interest rate could be set. Within the regions, their work made clear that the Bank was talking to people and taking their views on board. Mr Bailie said he had nothing but praise for the Agents with whom he had been involved, and that was true throughout Northern Ireland. He also noted the significance of an expansion of MSIF-type investment which was particularly important in certain regions bearing in mind that interest rates were inappropriate for them. Mr Hawker noted that the reputation of the Agent in Wales was very high and it was down to the individual and the local team. It was a two-way role, providing information to the Bank and communicating with the business community. In response to a question from Dame Sheila Masters about how the Bank ensured that special surveys contained representative samples, Mr Iles said the Agents talked to each other and to others in MA and put together a questionnaire and allocated proportions of types of contact and numbers to be contacted in each region, and that procedure was reported to the MPC. Mrs Heaton agreed with Mr Bailie and Mr Hawker and added that attendance by members of the MPC at events held by the Agents was extremely important. The Governor agreed.

Mr Stretton said there was an interesting question about the relationship between people like himself – who are seen as the local Non-Executive Director – and the Agent. He asked whether it would help if he saw the reports that came in locally through his region. He had been interviewed by the press on a number of occasions and it would help if that process could be reviewed and if he could be made aware of areas where comment would not be helpful. The Governor said that the Bank would certainly take that on board.

Mr Morris noted the value to the Bank and the contribution to the MPC made by the Agents. He wished to be sure that the method of collecting information was broadly consistent and had integrity. He was not suggesting fault lines, but it was very important that Court had a lot of confidence in the process. He asked whether the NED's relationship with the Agents, apart from invitations, could be thought about a little more. If certain members could be flagged as available in certain parts of the country that would be more productive. He asked Agents for their comments.

Mr Iles said that the Agents established best practice in discussions at their quarterly meetings. They realised that there had to be a good spread geographically and among companies, and tried to achieve this. He noted the Agents' small business panels and their contacts with CBI Regional Councils, trade union representatives and other organisations. The Agents hoped and believed that there was consistency across each region. Turning to links with Non-Executive Directors, Mr Iles noted that the Agents had had a number of NEDs visiting them, particularly in the last couple of years, and had tried to take account of local knowledge. Some NEDs had local connections and some had connections all about the country, and the Agents were aware of that as well. The Governor commented that the question of the relationship between the NEDs and the Agents required careful thought and that point would be taken on board.

Mrs Heaton commented that it was important to her to feel free to visit Manchester, for example, and she would have some reservations about being put into a South Eastern box. Sir David Cooksey said that contact with SMEs in each area was important to the Bank and to them. The only worry was whether there was a tendency to select the brightest and best because those were the ones that the Bank would hear about, and he said care should be taken that the sample was not skewed.

In reply to a question from Dame Sheila about the role of the Greater London Agent, Ms Hyde said one of the benefits of having an Agency in London was that it could cover the more distant parts of the capital. Part of the work was very similar to the work of fellow Agents. Where there were differences, they were related to the central presence. The London Agency talked to organisations such as the Engineering Employers Federation Economic Committee, the Major Contractors Group of the Construction Confederation and the head offices of companies with manufacturing operations elsewhere. There was great scope to extend what the Agency did, but that was related to resources. She would welcome guidance on how the London Agency related to the rest of the Bank and particularly to the NEDs.

MPC Procedures (Messrs Vickers, Plenderleith, Jenkinson, Footman, Berkowitz, Iles, Kemsley and Ms Hyde in attendance)

Mr King noted that there would be one more session in this series of discussions, in March. It would cover the resources of the MPC and material on the peer group review of the MPC. Mr Jenkinson introduced his paper on regional, sectoral and other information available to the MPC, including international and financial market information. Dame Sheila Masters said that the only question troubling her was getting a handle on "other" information. She wanted to make sure that Court had a clear understanding of what this comprised. In response to a question from Mr Stretton, Dame Sheila said that she should like the MPC to say whether it was satisfied with the information provided to it. This was an issue due to be discussed later in the morning at NedCo.

Mr Allsopp said that it had not occurred to him that there was any great statistical difficulty. The question was whether there were any obvious sources of information that the Bank was ignoring. He did not think that one could complain about a lack of information being fed into the process. It was a question about the quality of the data, particularly when it came to regional information, but that led to a different question – was there due process in thinking about it. He believed there was. He also noted that the Bank had a particular responsibility internationally, and he would be surprised if such information were not being used and he was quite comfortable that it was being used. Sir Chips Keswick commented that one of the best sources of information was from the Financial Services Authority.

Mr Davies noted that most of the data the FSA collected in a non-institution specific way was still collected by the Bank of England, and the FSA had a service level agreement with the Bank. He also noted that there were regular meetings with the Bank, and the tripartite standing committee role was to look for trouble. But the FSA had not been asked to submit anything additional beyond what the Bank collected on its behalf. It could be done, but he was not sure what it would be. The Governor commented that it would not be for the MPC side of the Bank. Mr Davies noted that for confidentiality reasons some of the detailed information on household deposits and loans and housing and mortgages was excluded from the pre-MPC pack.

Sir Chips asked whether the MPC ever asked Mr Davies questions about the number of banks going bust, capital adequacy and related matters. The Governor said that in any normal situation most of the information of that kind came out of the macroeconomic monetary data. In a very disturbed situation, the information would come from the financial stability side of the Bank which would be fed through to the MPC.

Dame Sheila noted that regional information was useful and it was of course understood that there was only one national inflation target. However this issue was not well understood outside the Bank and she proposed it should be given some prominence when the Annual Report was written.

Ms McKechnie noted the difficulty in looking at changes in consumer behaviour, for example the rise of internet shopping. This might shift very significantly some of the underlying trends in the national data. The Consumers Association was going to make a modest contribution by starting a consumer confidence monitor.

Mr Allsopp said it would be dangerous if Court were to find itself in the position of trying to sign off every piece of information, because it knew there were problems with some of the data. The question that had to be asked was whether the Bank and the MPC were capable of dealing with that uncertainty, for example with the earnings data. He advised strongly against taking the wrong route on this, but suggested that it would be helpful if, from time to time, the Bank and the MPC supplied a checklist of where information was regarded as deficient.

In response to Ms McKechnie, Mr Iles said there was continuing discussion involving the Agents and Monetary Analysis on how to pick up new trends such as internet shopping or an increase in mail order shopping. Even if the information were not as hard as the Agents would like, the attempt was being made, and that information got back to Monetary Analysis.

Mr King noted that after the separation of supervision from the Bank of England, careful arrangements for exchange of information were put in place. He noted also that the capital position of banks was reported in the Inflation Report. He said that when the average earnings index report was published in a couple of weeks' time an issue that would be discussed would be the relationship between the Bank and the MPC on the one hand and the Office for National Statistics on the other. There was already a formal agreement between the Bank and the ONS about the provision of statistics, but it was about the provision by the Bank of statistics to the ONS. The ONS had supply agreements with some customers. The MPC would want to discuss once the report was published whether there should be a similar formal agreement between the MPC and the ONS, and if that were to be the case it would be reported to Court, and it could be something that Non-Executive Directors could note and comment on in their report. Dame Sheila commented that it may not just be the NEDs but also the Bank that would wish to comment. Mr King suggested that perhaps the NEDs report could contain no more than a sentence noting that they were aware of it.

International Economy – Prospects for the World Economy (Messrs Vickers, Plenderleith and [redacted] in attendance)

Mr Vickers introduced [redacted], who would be joining the new International Division in Monetary Analysis on 1 March. Since the Autumn, some of the financial fears in developed economies had eased somewhat. Financial fears elsewhere were a different matter. However, the economic outlook for the industrial economies had worsened significantly since the Autumn. This was a consequence of problems in emerging markets which resulted in a substantial diminishing of capital flows to them. In the US, the expansion was remarkable but external imbalances were getting wider and there were risks associated with that. One of the questions was whether there would be a soft landing back to trend growth or something more severe, for example if the US equity market should have a sharp fall. In Japan, there was no end in sight. On Continental Europe, which ideally would be the engine of growth if the US was falling back to trend, growth was sputtering at the moment. Business confidence indicators had fallen quite sharply in a number of euro zone economies, partly as a consequence of trade with emerging markets, and there was also the question of the interaction between fiscal and monetary policy in Euroland. A number of forecasters had revised down their growth forecasts for Euroland. World trade growth, which had been very strong for most of the mid '90s, had fallen very sharply. The question was whether the mid '90s had been an aberration, because of the European Community's move towards a single market, NAFTA and trade liberalisation in emerging markets. World trade growth might now be falling back to trend.

[redacted] noted that UK trade was behaving differently from world markets. In the UK services exports were growing slightly stronger than goods, but OECD figures showed that world imports of services were weaker than those of goods. That could be because of financial difficulties in 1998 that led to lower trade in financial services, but there might be other reasons as well. In response to a question from Mr Buxton, [redacted] said that over the last ten years world trade in services had been growing faster than trade in goods, but the OECD data for 1998 showed weaker growth in services. He believed that might be temporary. Mr Allsopp said that the paper identified all the right events and risks, but he asked whether it was possible to include fan charts in it as well. Mr Vickers said that it was certainly true that most observers saw the balance of risks on the downside and that was incorporated in the fan charts for the UK but there were limitations on whether this could be taken further in an international fan chart.

Mr Davies, commenting on key risks, said that the FSA would have included more about financial sector problems, particularly in Japan where the recapitalisation of the banks was an important part of the problem. The Japanese FSA was very determined at the moment but unless it could force change through this year the prospects of a Japanese recovery were considerably worse. The FSA was also worried about China, where a lot of the banking system was bust with large loans to state enterprises. China was not far off where Korea, Malaysia and Indonesia had been in 1997. This did not mean there would be a crash, because China's external position was different. China was aware of the need for a huge restructuring, but the costs were very large and it would amount to a double digit percentage of gross domestic product to recapitalise the banking system. The FSA might have come to a slightly more pessimistic conclusion than the Bank paper.

FINANCIAL STABILITY ISSUES

Developments in international markets (Messrs Vickers and Plenderleith in attendance.)

Mr Clementi noted the need to recapitalise banks in Japan but said that, in a sense, that was the easy bit. The Japanese also had to rationalise their banks, and that was much more difficult because there was a cultural problem in dealing with it.

Mr Clementi noted that the Bank had reported the previous month on the collapse of the original International Monetary Fund deal in Brazil. Events were being monitored carefully. Brazil now had its third central bank governor in a row. The IMF in Brazil had put out a broad statement at the beginning of the month about the way they hoped to move, and it was hoped that that would be followed by a more detailed statement shortly. Mr Clementi noted that the premiums on sovereign debt had come back from their peak in mid January and he commented that Brazil and also Argentina and Mexico were in the midst of an uneasy calm. Sir David Lees noted that there had been a good deal of discussion of the UK, but not much about Euroland. If Euroland went downwards the impact on the UK would be very significant, particularly if at the same time the US were faltering. He asked whether Court could spend longer talking about Euroland, through Mr Vickers. The Governor commented that this was an excellent idea for next month or the month after. Sir Chips Keswick asked whether it could include material on structural problems in Europe and subsidies to credit markets. The Governor said the Bank would do its best.

FINANCIAL MARKET OPERATIONS ISSUES

Executive Report

Mr Plenderleith drew Court's attention to the fact that the customer gilts service was now operative. It was on an execution basis and there was no position risk to the Bank. He also reported to Court that the Bank had taken on board a representative of the IMF in London, who would keep the IMF more closely in touch with the markets. The IMF had asked if the representative could be implanted in the Bank. He commented that it was a healthy development for the IMF and helpful that they should think to ask the Bank. The IMF's representative was joining the following week.

MANAGEMENT OF THE BANK

The Bank's budget for the year 1999/2000 (Messrs Plenderleith, Vickers, Midgley, Footman and Berkowitz in attendance)

Mr Clementi noted that Court had looked broadly at strategy and objectives in November and December last year. Court now needed to look, and he hoped approve, the budget. He would also focus on CRDs, which were set at 0.15% last year. He noted that when the ten objectives were brought to Court, it was realised that number nine could not be finalised until Court looked at the budget. Court would also be asked to look at the letter to the Chancellor covering the items he had just mentioned.

Mr Clementi noted the importance of page A1 of the budget documents. This showed broadly that the Bank's income for the year would be £321 mn and budgeted expenditure would be £213 mn, giving a profit of £108 mn for the year and a return on capital of 8.1%. But to the extent that it looked like a private profit and loss account it was deceptive because the Bank was not a profit maximiser in the long or the short term. There were two questions: on the expenditure side was the Bank spending money sensibly in relation to its strategy and objectives; and on the income side was it investing its capital and reserves wisely, not necessarily to maximise income, since it was a central bank?

Mr Clementi drew Court's attention to the expenditure breakdown on page A3. The largest increase was in the Printing Works, relating to the new variant note which had been agreed with the Treasury. The increase in Printing Works' costs hid quite a substantial reduction in head count. Head count was quite a good measure of what the Bank was up to. He drew attention to page A4. There had been no significant contracting out this year, he noted. The numbers had fallen by about 80 this year and the Bank was budgeting for another reduction in 1999/2000 of about 50 and further reductions in the remaining part of the medium term period. This was a net figure, different from the gross. In the process businesses such as Printing Works, Registrars, Banking Services and Property Services, the number of people was going down. But in certain of the others – analytical areas of Monetary Analysis, Financial Stability and Market Operations – Court would see an increase in the numbers. Monetary Analysis was showing an increase of 10% or about 20 people budgeted in the period. Within the fall in numbers there was therefore a reallocation of resources.

Mr Clementi noted that the Bank was an expenditure-led organisation and had to fulfil the obligations put on it by the government. Returning to page A1 he noted that the return on the Bank's gilt portfolio, totalling some £1.4 billion, was an income of £131 mn, or 9.1%, and this reflected enormous credit on those in Court and on the Executive Committee when they decided to take a long view of the gilt portfolio. A yield of 9% was well above other long term rates. At the short end, the return was closely in line with market rates and well below last year, partly because interest rates had fallen and partly because the level of CRDs fell in June. Mr Clementi noted that two thirds of the Bank's income flow was from its balance sheet assets.

Returning to charges recovery, Mr Clementi noted the £12 mn payment for services provided under Treasury cash limits such as management of the reserves and the Registrars, both on a cost recovery basis. On the note issue, the Printing Works was essentially on a cost recovery basis. It was shown as a recovery, but was taken off seignorage in practice. He noted that there was not very much income from the Financial Services Authority, most of whose staff had moved out on 1 December. In Banking Services, the key lines on the income side were either cost recovery or return from investments where there was no active management and key decisions were made infrequently.

Mr Clementi noted that the Bank had promised to come to Court with a paper later in the year when a significant proportion of the gilts portfolio was due to be reinvested, setting out how that should be done.

Mr Clementi commented that in his view the budget broadly flowed from the Bank's three core purposes and ten objectives. The Bank had tried to set out a detailed map which set out the ten objectives and showed what work was being done in each part of the Bank to support those.

Returning to CRDs, Mr Clementi noted that the equation had three variables: first the cost of running Monetary Analysis and Financial Stability, which was rising; second interest rates which had fallen by a fifth; and third, CRD levels, which were not rising enough to compensate. Prima facie, it would seem necessary to go back and look at CRD levels again. However, two things stopped that. The deal with the Treasury had been intended to cover five years. Though it was envisaged that it would be reviewed annually, it was a medium term arrangement, and that should be honoured, particularly as it had been known at the time of the agreement that the gilts portfolio gave a buffer that allowed the Bank to take a longer view. The Bank's recommendation to Court was that, this year, CRDs should be left at their present rate.

Turning to financial objective number nine, Mr Clementi said that the Bank's proposal was set out on page 13, paragraph 33 of Mr Midgley's paper: "To maintain the Bank's overall spending within the agreed budget of £213.2 mn for 1999/2000 set by Court in the context of the medium term framework for its finances described on page XX of the Annual Report, which calls for a £20 mn reduction in overheads, including property costs." Mr Clementi commented that the Bank believed that the financial objective should concentrate on costs, both short and long term. In the short term the Bank must live within an agreed budget. In the long term it should also have an objective, which had been discussed in Court before, of taking out £20 mn from overheads. Of the reduction of £50 mn due to the transfer of supervisors to the

FSA, £30 mn had walked out of the door with the staff, but none of the overhead had gone. This £20 mn had to be taken out. In fact, the budget proposed that £17.4 mn should be taken out of overheads in the period. It was complicated, since the reduction because of the loss of supervision was offset by growth in a number of areas. Nevertheless, it was felt that the £20 mn should be explicitly referred to in the financial objective so all staff could see the direction in which the Bank was heading.

Mr Clementi noted that in the first draft the rate of return had been included but it had been taken out since. The rate of return for the Bank was something of an anomaly. There was a case to be made that it should be falling to perhaps 5.5% because of the fall in interest rates, but because of the gilts portfolio the actual return was likely to be 8%. This point was hard to encapsulate and was best set out in the medium term report and in the Annual Report. Rate of return was a misleading and blunt instrument for determining whether there was financial discipline in the Bank. The recommendation was that the rate of return should not be part of objective nine but should be in a longer paragraph in the medium term outlook. Finally, Mr Clementi drew attention to the letter to the Treasury, which reflected the issues he had described.

Sir David Lees supported Mr Clementi's remarks on rate of return but suggested that it would be wise to cross refer in objective nine to the explanation of return on capital in the medium term report. Without such a reference it would appear to be an omission. Court agreed to an amendment to objective nine, inserting the words "and the benchmark return on capital". This now read "to maintain the Bank's overall spending within the agreed budget of £213.2 m in 1999/2000 set by Court in the context of the medium term framework for its finances and the benchmark return on capital described on page XX of the Annual Report, which calls for a £20 mn reduction in overheads, including property costs." Dame Sheila said that while she was pressing for rate of return to be included in the objective she was content with the proposed formulation. Sir David Lees also asked for an explanation of the phrase "non-recurrent expenditure" in the schedules. Mr Midgley said that investment expenditure included direct and staff costs associated with the investment. Most of the Bank's expenditure was in building and developing computer systems. In the first year of the budget there was a lot of Year 2000 and EMU related expenditure. These were listed as projects later on. In response to a question from Sir David about where the genuine non-recurring expenditure such as the cost of reducing staff and property expenditure appeared, Mr Midgely said that some of these were also included, such as Head Office refurbishment. Severance costs were not included but direct expenditure on all the projects was.

Dame Sheila Masters noted the importance of concentrating on controllable elements. Dame Sheila asked about the process by which the budget had been arrived at; she said it was important to be clear about the definition of £20 mn saving because it would be necessary to measure backwards after it had been achieved, and it would be wrong to have a formulation that the Bank could not point to at a later stage; she commented that there was still a relatively high percentage of overheads and asked whether there was something else that Court should be looking at; she also noted that there were £100 mn of charges where the objective was covering costs, and there was no statement that that should be done. It would help to have one, to give assurance that the financial objective was being complied with.

Mr Clementi said that the budget process had been undertaken in the standard way, including discussions with Heads of Division. On the question of whether £20 mn was enough, he noted that there were areas of reduction, offset slightly by other areas where the obligations on the Bank were increasing, for example servicing Court and the amount of publicity the Bank now generated. There were areas where more had to be spent, which would be offset by others where there would be savings. On income and expenditure, he said there could be some mapping, but he thought it might confuse as much as it helped, although he would be happy to do it. Dame Sheila said she was looking for reassurance.

Mr Midgley said that if the question was whether the £20 mn was in real terms, the answer was yes. Three quarters of it was related to gains from property reorganisation, and the other £5m was from overhead areas, most of that coming from Personnel. The Bank would be coming to Court with information about specific areas where these savings would be made, and about the expenditure associated with them. Dame Sheila said she knew that the figure was in real terms but she had a feeling that it related to the previous year. The Bank needed quantified objectives that could be demonstrated clearly to the outside world. Mr Midgely noted that there was a line in the table comparing the figures to 1997/98. That year had been chosen because it was the base year agreed with the Treasury for CRDs. The £20 mn was taken at 1997/98 prices.

Mr Midgely said that table 1 attached to his note gave Bank expenditure in a financial accounts framework. He drew attention to the figure £47.7 mn for the year 2002/03. That showed a reduction of £17.4 mn in total overheads and internal services. Business unit expenditure dropped £30.3 mn, giving the total reduction in current expenditure as £47.7 mn.

Dame Sheila said that she believed there would be some difficulty in explaining that to the outside world. She asked whether anybody reading the report would understand what the Bank was trying to secure. Mr Midgely asked whether she thought objective nine would look a little weak if the Bank did not measure a £20 mn saving. Dame Sheila said it would look weak if it was not explained. Mr Midgely said that it would not show as £20 mn but as a bigger number. The Governor said that it would be better to come back to this question in the discussion of the text of the medium term plan.

Mr Buxton commented on the importance of IT expenditure and he said he could not tell from the budget what that was for the Bank. Turning to CRDs he noted that he had a conflict of interest as Chairman of the BBA, but he said that from the Bank's point of view it was important, if rates were to be raised, to demonstrate cost savings. An increase would be understood by the banks provided that it was demonstrated. Banks did not necessarily expect CRDs to be fixed for five years provided the Bank could show costs coming down. The Governor said that the Bank's proposal was that there should be no change this year. The draft letter to the Chancellor flagged this fact, but the Bank might have to propose an increase next time, if low interest rates persisted. Mr Buxton suggested the Governor might like to make that point to the banks. Mr Clementi said that with Court's agreement he would speak to the Chairman of the British Bankers Association (Mr Buxton) after this meeting.

Sir Chips Keswick said for the fifth year in a row he wished to make one more plea about the concept of return on capital which he believed was a bomb waiting to go off. Sooner or later somebody was going to say that the Bank was insider trading. It would be accused of making a profit because it knew what the Monetary Policy Committee was going to do. He noted the importance of the return the Bank made on its free cash, and asked for care to be taken with the concept of return on capital, which was a minefield. The Governor said that it was clear that it was reasonable for people to expect the Bank to manage its free capital against a benchmark. The benchmark was the calculation the Bank needed to do to arrive at the appropriate level of CRDs, and was not a target rate of return. That was a distinction he would explain. If it was confused, there would be problems.

The Governor asked whether Court was content with the budget. Court was content. He asked Court whether it approved the Bank's proposal that it did not seek a change in the CRD rate. Court was content. He noted that Court had not yet approved objective nine, though there was a presumption that it was an improvement. Court could wait until it saw the draft medium term objective for the Annual Report where the Bank might try to make Sir Chip's point about the different nature of benchmarks. The Governor asked Court to approve the draft text of the letter to the Chancellor. Mrs Heaton pointed out that a line was missing and this was restored. With the missing line inserted, Court approved the draft text.

TARGET – Effect on Balance Sheet (Messrs Vickers and Plenderleith in attendance.)

Mr Clementi noted that at the end of December the balance sheet footings were £9 bn, and six weeks later they were £73 bn. Within Target, each central bank had an account with the other 14 and with the ECB, and for structural reasons the balances were not netting out. The Bank's net position was around just under £1 bn each night. But the gross position was very large. This had been raised with the Audit Committee in December, which had taken the view that under normal conventions the Bank would have to show the gross amount, as there was no right of set-off. This would lead to a substantial distortion of the balance sheet. The Bank was raising this with European colleagues. If all central banks could settle at the same time, the amount would come down. Continental central banks had realised they had a problem too, but their year ends were different. Mr Plenderleith was going to see the ECB on Friday.

The Governor noted that the Bank hoped to clear this point up by the balance sheet date. If that were not possible, it was hoped to clear it up by the time the Annual Report was published as a post balance sheet event. If it was not possible by then, it would have to be noted that the Bank had made others aware of the problem. Mr Buxton said that the solution would be a netting agreement. The Governor agreed, and said the Bank would continue to argue for that in the ECB.

Annual Pay Settlement (Messrs Vickers, Plenderleith, Footman and Matheson in attendance)

Mr Footman said that the pattern for pay for the last two to three years had continued this year, and would probably continue for a year or two to come. There were fewer staff, and a richer staff mix as the Bank increased the number in analytical grades, particularly in Monetary Analysis, and as it moved to more flexible ways of determining pay. He noted an optical effect, in that if outside readers of the Annual Report compared pay bills between years, they would see the average pay of Bank staff rising 9% last year and 6.5% this financial year. These numbers required explaining, which was why Mr Matheson's note concluded with the discussion of that sensitivity. The Bank was still within the public sector pay bill constraint. As a result of the move of staff to the Financial Services Authority the pay bill limit had fallen to £87 mn, and the Bank was below that this year at £84 mn. The Bankwide settlements achieved over the last few years gave satisfactory performers increases in the region of 2.5%. This year the Bank had a general increase in banking and information technology of 2.25%. The rest of the increase was effectively at management discretion in the form of merit and bonus money. On merit money, the Bank had distributed about 3% to banking staff. There was also quite a large bonus pot at management discretion. This allowed the Bank to reward people heavily involved in conversion to the euro or in dealing with the pressures surrounding the MPC process. In the past couple of years bonuses had been used to ease restructurings, particularly of clerical staff.

For those at the bottom and near the top of the pay scale there were recruitment difficulties apparent, but in the middle of the Bank there was a problem in that pay had been allowed to grow too far, and in the recent restructurings about 100 staff had had their salaries frozen. The bonuses had allowed the Bank to get the restructurings through, and reward performance in a non-pensionable, non-repeated way.

The Governor commented that the issue was not about the settlement but about the presentation of the settlement. He asked Court whether it was content to take note of Mr Matheson's paper. Court was content. He proposed that the discussion of the staff benefits review be deferred to another meeting and he drew attention to the Sealing Committee authorisations. In accordance with the terms of reference of the Sealing Committee the record of authorities granted by the Committee was laid before Court for inspection. There being no other business, the meeting ended.

17/3/99

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 MARCH 1999

Present:

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Stability

Mr Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Mr Davies

Mrs Heaton

Sir Chips Keswick

Sir David Lees

Ms McKechnie

Mr Morris

Mr Neill

Sir Neville Simms

Sir Colin Southgate

Mr Stretton

The Minutes of the Court of 17 February, having been circulated, were approved.

MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court (Mr Vickers, Sir Alan Budd and Dr DeAnne Julius in attendance)

Introducing the discussion, Mr Vickers noted that the March minutes of the Monetary Policy Committee showed that the vote in favour of no change in interest rates was 8 to 1, with Professor Buiter preferring a 0.4% reduction in interest rates to 5.1%. Turning to the international outlook, Mr Vickers said that the view in last month's Court paper of strong US output against a background of weakness in the rest of the world still held, and perhaps more so. The February consensus forecast of world GDP growth was 1.7% for 1999, the lowest for almost 20 years. Last year growth in the United States had contributed half the world's demand growth and in the first quarter of 1999 showed no falling off. The NAPM manufacturing survey data in the US showed a bounce, against the background of a huge deficit and emerging protectionist pressures. Inflation remained subdued in the US, partly due to weak commodity prices, but he noted increases recently in the price of oil.

In Japan, there were not many green shoots to report, though there were signs of the fiscal stimulus coming through. He noted that the Nikkei index was up quite strongly to about 16,000 over the month.

In Euroland, Mr Vickers noted weakness in Germany and Italy and a stronger performance in France. The Euro had weakened, despite the bounce following the resignation of Mr Lafontaine. The markets expected some easing from the European Central Bank in the first half. An interesting question was the difference between the MPC's point target and the 0-2% range of the ECB. This was an issue that would be taken up in the paper promised to Court on Euroland.

Turning to the Budget, Mr Vickers said that the MPC had been briefed on its shape before the March meeting. The forecast for growth from the Treasury was broadly in line with the Bank's February forecast, though the lower end of the Treasury range was a little stronger than the MPC forecast. The Budget measures comprised a £6bn loosening over three years, mainly of taxation; this was slightly more than offset by lower social security and debt interest; there was little change to the borrowing projections. Short sterling had reacted adversely at first, then it recovered. Mr Vickers noted that the Bank's analysis of the detailed measures was continuing.

Turning to the new average earnings series, Mr Vickers said that there was a need for caution because there were still problems with the sample. But the new series at least chimed with other data, for example settlements, and fitted in with economic logic. It showed a steady upward path of earnings growth from 3% in 1995 to a peak of 5.7% in 1998, Q2: if anything growth was stronger in the first half of 1998 than the MPC had thought at the time. Since the middle of last year there had been a fall to 4.3% for the three months from November to January. Changes in overtime, hours worked per head, bonuses and inflation expectations were among the explanations under analysis now. Mr Vickers also drew Court's attention to labour market quantities and other recent data. In the absence of Mr Plenderleith he described developments in the markets, noting that for the period 2000/2001 the implied future rates of interest had moved up somewhat. There was very little action in 1999 futures contracts. Two years ago, the implied rates for 1999 were around 8%, which showed how much change there had been. He also drew Court's attention to what was now called the Millennium Dome effect, a reference to the impact on yields of fears of a liquidity shortage at the end of the year. Mr Vickers noted that, in Chart 5, 10-year nominal yields had increased in February, but were steady in March. However, index-linked yields were still low. The rising spread might signal higher inflation in the market's eyes, looking further ahead.

Mr Neill noted a confusing picture in the car market, which had fallen further than expected in February, with the market as a whole down 52% and the retail end down 60%. However, in the first 10 days of March, following the new registration numbers, sales had risen 194%, with retail sales up 295%. If March tracked August, the whole market could be up between 3% and 5% in the first quarter compared with the previous year. He also noted that the import share in March and February had been about 72%.

Mr Bailie noted that in recent weeks business confidence had started to creep up again and perhaps people thought there was not going to be a recession. Printing and packaging employers had agreed a wage increase of 2.4% on the basic rate, which worked out overall at less than 2%. Sir Neville Simms commented that little had changed in the construction industry, where activity was buoyant but orders were declining quite fast. There was no recession, but there was a slow down. Mr Buxton agreed that confidence had improved a little, but the trend was still negative. People were beginning to see a slow down whereas at one stage they had been looking to a real collapse. Barclays' gross bad debts in the first two months of the year were only £15mn. Mrs Heaton noted an upturn in business from mid-cap companies compared with last year. Sir David Lees expressed doubts about movements in interest rates other than in multiples of 0.25% because they implied an unrealistic degree of fine tuning.

In reply to a question from Mr Morris, Mr Vickers said that movements in labour market quantities were not so much due to cyclical effects as to longer run secular changes in the labour market, particularly growth in female and part-time employment, and also some sectors were growing quite strongly. Over the last year, it was these, rather than cyclical factors, which had stood out. In reply to a question from Mr Morris on the earnings numbers, Mr Vickers said that there were various hypotheses explaining the recent reduction in growth rates. Hours worked per head seemed to have fallen quite sharply and the overtime built up a year ago had unwound. He believed bonuses were also part of the story. Their contribution to growth of earnings may be negative. It was however only a couple of weeks since the report on the ONS, and analytical work was continuing to prepare a briefing for the MPC, ahead of its April meeting.

MPC Procedures (Messrs Vickers, Footman, Berkowitz and Jenkinson and Sir Alan Budd, Professor Willem Buiter and Dr DeAnne Julius in attendance)

Mr King noted that there were four documents on the table: first, a new timetable of pre-MPC meetings. Second, a peer review of pre-MPC meetings which was a compilation of the views of visitors from overseas central banks and international financial institutions who had been asked to write an appraisal of the meetings they had attended as a basis for the report on the operation of the MPC. Third, a paper on the inflation forecasting track record. He noted that there were two ways in which the record was appraised. Each quarter the MPC looked back at the previous forecast as part of its regular activity. The Bank also published irregularly a backward appraisal of the forecasts made two, three or four years ago. A note published in the February 1996 Inflation Report was attached. It was still too early to do that for the period covered by the MPC as it had not yet been in existence for two years. But the MPC would start this August with an annual appraisal of forecasts of the previous year made two years prior to that. The fourth paper to which he drew Court's attention was on the resources provided by the Bank to Monetary Analysis and the MPC.

Mr Jenkinson, describing his paper on resources, gave three definitions of the resources supporting the MPC, ranging from narrow to wide. The total cost borne locally, before central costs, would be 8% of the Bank total on the first definition, 10.5% on the second and 14% on the third. Mr Jenkinson noted the difficulties of external benchmarking, and drew attention to tables 4 and 5 in his paper which showed two different attempts at this, one based on BIS comparisons, in which the UK came out on the low side on costs, and the other based on numbers of economists employed, obtained by telephoning central banks abroad. The latter showed that the UK was similar to France and Germany but employed fewer than Italy and the Federal Reserve. Finally, he noted that support provided to MPC committee members was broadly similar to arrangements in other countries.

Sir Chips Keswick suggested that the benchmark should be based on GDP, which was what the monetary policy process was trying to prove. He also noted the great importance of spending on information technology. Mr King said the question was whether expenditure was sufficient to produce an adequate product. Sir Chips said that the members of the MPC were the professionals and they must know whether they had what they required. Mr King noted the exercise in which Dame Sheila Masters would speak to each member of the MPC as part of the review of procedures. He also noted the importance of the Bank's recruitment plan for economists, and said that the Bank was now the leading employer of economists in the UK. Mr Allsopp said the paper was useful in providing a few benchmarks, but he was struck by the rather limited resources in Monetary Analysis compared with the rest of the Bank, and MPC resources did not stand out internationally as expensive. More interesting in the context of Court's statutory responsibilities were the procedures in place for making sure that resources were being reviewed, for example on the international side.

Dame Sheila Masters said that had been done in the context of the budget last month, which was the result of a review process in which all the Executive Directors discussed the resources required for the coming year. She took the paper to indicate that the Bank was not seriously out of line with others. There was nothing to show that the Bank was extravagant or seriously under-resourced compared with other institutions. That was why, for her, table 5 was the most interesting.

Mr Buxton said that the most important point Court had to deal with was whether the MPC achieved the right results. In terms of systems and information gathering, Court had to look at the costs, and the paper made him feel more comfortable. Mr King commented that Sir Chips had raised an important issue in information technology, where improvements were needed, but this was best done in the context of the budget. Sir David Cooksey said that the paper was valuable, but only if it were the first in a series. Dr Julius commented that there was no subsector of the US economy that was as well resourced compared with its output as the Federal Reserve system. This was partly because of the structure of the system. It would be extremely difficult on cost benefit grounds to justify that level of resources in the UK. She also noted that there may well be pay issues in the recruitment of economists. Experienced people were expensive.

Sir Colin Southgate said the measure should be whether the Bank was able to get the 20 economists it was seeking, of the right quality, over the year. In response to a question from Ms McKechnie, Mr King said the Bank had to find enough people to ease the pressures that had built up since the start of the MPC. Research by economists had to be work that the Bank wished to be done, and the Bank would not hire people who wanted to do unrelated work. Research had to be in areas directly relevant to the MPC.

Mr Jenkinson noted the great effort put into recruiting. He said an advertisement in The Economist before Christmas had led to 100 applications which had at this stage been reduced to seven experienced people. Separately, the Bank was trying to recruit PhDs, and had made three offers to candidates it had flown back from the American Economics Association Conference. One had turned down an offer. Sir Colin Southgate noted the importance of measuring the loss rate, as well as recruitment.

Sir David Lees commented that the Bank should be careful when it came to the Annual Report not to appear to show that it was spending too little on the MPC. There were costs in other parts of the Bank attributable to the MPC. There should be careful thought given to what was disclosed in the Annual Report.

Sir Colin Southgate suggested taking out the general overhead for all other areas when making the comparisons. Dame Sheila noted that there was no easy way because about half of the costs were central costs.

Sir Alan Budd noted that where research projects were concerned, the trick was to provide a very high quality research environment for economists, while making sure the work was relevant to the Bank. Professor Buiter said he believed that the price that might have to be paid was to let some of them do work that was irrelevant to the Bank. He noted that such people could triple their pay by moving elsewhere or could move to academia and be paid very little.

The Bank was a half-way house. It was a question of trading job satisfaction against cash. Mr Vickers commented that the Bank wished to get the ratio of research work up, but it would be Bank-related research.

Turning to the peer review, Mr King noted that there was no selection in the answers provided to Court, which were based on the responses of those who came to the pre-MPC meeting. Mr Allsopp said that the sub-text was the expense of the pre-MPC meeting, and Court had to take a view. Dame Sheila Masters said the MPC had made some suggestions and there were alterations being made to the programme and to the data provided to the pre-MPC meeting. The collective view was that there was a need to modify what had been done to date. Mr Vickers said that there might be a reduction of as much as 40% in the number of slides produced. He also noted possible efficiencies in the production of the chart pack.

In response to a question from Sir Colin Southgate about whether a paper would be prepared on IT support for the MPC, Mr King said he believed consideration of this issue would be in the next budget round. A major investment had been made two to three years ago and more recently there had been a significant investment in IT for the Agencies. Sir Colin commented that he felt it was important to bring in IT staff from outside. Mr Buxton also noted the importance of IT.

Dame Sheila Masters said Court would be interested in looking at the IT issue. At the point where the Bank had a clear view of the strategy she hoped Mr Jenkinson would bring a paper to Court to explain it. Mr King agreed and said it would be very helpful to do so.

Turning to the forecasting record, Dame Sheila said she was glad to hear that there would be a page in the August Inflation Report. Sir David Lees said that thought should be given to including comments on this subject in the Annual Report, though not for this year.

Mr Allsopp said that assessment of forecasts was a nightmare, as the paper indicated. One way to tackle it was to publish performance against outturn. But the problem was what to do with that data. To explain it properly required sophisticated analysis and quite a lot of text before any judgement could be formed. He suggested splitting the information between a straight account of the forecasting record and an occasional detailed analysis. Mr Morris said there was a case for answering such questions from the point of view of public accountability. Dr Julius noted that there were two ways of assessing forecasts. One was a technical assessment, in which it was necessary to adjust for what with hindsight was not known at the time of the forecast; the second was a retrospective analysis of where the mistakes had been made, and how to avoid them in the future. She noted the constraint of the constant interest rate forecast made by the MPC, so that the same element of adjustment would be brought up time after time when looking at previous forecasts. Professor Buiter agreed that, where forecasts were in the public domain, anybody with a slide rule could compare the outcome with a forecast. The more interesting problem was to explain where the errors came from, and that analysis would involve information that was not in the public domain. Sir Alan Budd commented that both the Treasury and House of Lords Select Committees would take a considerable interest in this question of forecasting performance. Dame Sheila noted with approval the plan to put a page in the August Inflation Report on forecasting performance and she also noted with approval Sir David Lees' point about putting a reference to the subject in the Annual Report, but not this year. Sir David said that forecasting was the output of the Bank, which was spending millions on it, and it would be surprising if the Bank could not say how it had performed against forecasts. Readers of the Annual Report would expect that.

Review of Earnings Data (Mr Vickers in attendance)

Mr King described the sequence of events the previous October when the earnings figures had been revised up on 6 October followed by a second announcement on 14 October which showed a very different picture. In late October, the Chancellor had asked himself and Andrew Turnbull, the Permanent Secretary of the Treasury, to carry out an enquiry, and they in turn asked Martin Weale and Peter Sedgewick to carry out the work. The terms of reference covered both statistical and management issues.

Mr King noted that there had been problems in the old series, which had been inherited from the Department of Employment. There was also a geographical problem, with the work at the ONS split between Runcorn, Newport and London. He noted that the ONS had tried to increase the weight of financial services firms in its sample, because there were very few of those. But the result was, that as a result of large bonuses, two small firms with fewer than 100 staff between them had produced a change in the average earnings index for the whole economy of 1%. Similarly, a single healthcare firm with fewer than 50 employees had produced a 0.75% change.

The problem was not the theory but the practice. The sample was poor because there were not enough firms from appropriate industries. Furthermore, the internal procedures of the ONS for managing change were flawed. The Director of the ONS himself had had serious misgivings about the new series before it was published.

For the Bank, the specific recommendation of the Report was that there should be a full Service Level Agreement between the ONS and the Bank in respect of statistics the ONS collected which were used by the MPC. The Report also had a number of recommendations about the future work programme for the average earnings index, which was not yet up to best statistical practice. There would be a question mark over it for some time to come, until further changes were implemented. However the index now published was a lot better than the one released on 14 October last year.

In response to a question from Mrs Heaton about whether the Bank was exposed to the risk of other similar problems, Mr King said it was possible with any series. However, the AEI had been inherited from the Department of Employment. When the Central Statistical Office became the Office for National Statistics, its primary concern was incorporating the Office of Population, Census and Surveys, and not enough attention had been paid to statistics acquired from other Government departments. So it might well be that the problem was not an across the board one. The Report on the ONS proposed involving people both in and out of the Government where changes were being made in statistics. The AEI episode was unfortunate, but he did not believe it was symptomatic of the whole of the ONS.

In reply to a further question from Mrs Heaton about whether checks should be made, Mr King said that there were quite close contacts at staff level. For example where services statistics were concerned, the Bank's concerns were shared by the ONS. In the case of the AEI, the problem was that there was a management failure to understand that there was something wrong with the series. The Bank's other concerns were not on the scale of those of the AEI.

He noted, in response to a question from Sir Colin Southgate, that statistics for capital flows were poor because capital controls on the economy had gone. In response to a further question from Mrs Heaton, Mr King said that the Service Level Agreement with the ONS would make a big difference. He agreed to a request from Dame Sheila Masters that when the agreement was completed he would brief Court on it, and in particular would brief on areas where he had concerns. Mr King said the agreement, which should be completed within two to three months, introduced a new regime, rather than setting out areas the Bank was worried about. It was a framework in which discussions would take place about the use of resources.

FINANCIAL STABILITY ISSUES

Developments in International Markets (Messrs Vickers and Clark in attendance)

Introducing the discussion, Mr Clark said that in Brazil a new programme had been largely agreed with the International Monetary Fund. There were still one or two elements still to be resolved. The programme would probably go to the Fund about the end of the month. It was formally a re-jigging of the programme agreed last autumn. Since then the Real had floated, which significantly changed the arithmetic. The programme envisaged a series of further fiscal actions and (eventually) the adoption of an inflation target approach. Brazil had received a positive response from banks, which had met in a number of centres to discuss the general approach, including London the previous Friday. There was broad agreement to keep funding in place. If there were doubts about the programme, they concerned the interest rate projections and the implications for debt dynamics. Given the quantity of short-term debt and continuing high interest rates, there could be an explosion of Government debt over time.

In Russia there were tentative signs of progress in discussions with the IMF, but it was a long way short of the basis for a new programme. In the background was the prospect of a wider default. Russia had heavy maturities this year, and for the next two to three years.

Turning to Japan, Mr Clark said that the authorities had published very much more detailed proposals to restructure the banking sector, with four to five banks withdrawing from international business, and a significant scaling back by about 10 others. After the process had been completed, there would be five or six banks with significant international presences. The capital injections being made now would be repaid over periods from three to ten years. In theory, by the end of March this year the balance sheets would be written down to reflect the values the Japanese banks had agreed with the Japanese Financial Services Authority.

Mr Allsopp commented that the biggest risk of all was in the US. He also asked whether, given Japan's vast budget deficit, something had gone missing in the figures, and was perhaps going into the banking sector. Mr Clark said he was not aware of much evidence of that happening from the bank balance sheets. Mr Clementi commented that the US risk related more to monetary policy concerns. The Bank did not judge the financial stability risks in the US to be great although there had been concerns following the LTCM difficulties last year. Mr Clark said that there would clearly nevertheless be a knock on effect in Japan and elsewhere if there were a rapid economic slowdown in the United States.

Mr Davies said that the FSA, after discussions with the Japanese Financial Services Authority, believed the capital position of banks in all but one or two cases was slightly better than previously thought. He commented that at the moment the FSA had quite a high confidence in the top management of its Japanese opposite number.

MANAGEMENT OF THE BANK

Interim Payment to HMT in lieu of Dividend (Messrs Vickers and Clark)

Mr Clementi said it was the Bank's practice to pay an interim dividend at this stage. Court AGREED that pursuant to Section 1 of the Bank of England Act 1946, and Section 8 of the Bank of England Act 1998, an interim payment of £32.45mn be paid to HMT, in lieu of dividend, on 1 April.

Staff Benefits Review (Messrs Vickers, Clark and Footman in attendance)

Mr Clementi said he hoped to modernise the Bank's benefits package so that the level of benefits reflected contributions to the Bank. It was intended to move to a percentage of benefits geared to salary. A core element would be pensions, basic medical insurance and basic holidays. Staff would then be able to pick from a menu their additional benefits - for example there would be an option of extending medical benefits to other family members. The proposals were broadly modelled on FSA lines.

Mr Clementi said there were three concerns. First, if it was agreed that this was going in the right direction, getting there would not be easy. There were a small number of staff who were over-borrowed and transitional arrangements would have to be handled with sympathy. Second, getting agreement with the staff would not be easy, and Court's support for the line taken by the Executive would be helpful. Third, noting points made previously by Mr Buxton, he said there was the question of why the Bank was not approaching the issue of benefits for pensioners. This was not ruled out, but it was even more difficult, and had been put on a back burner.

In response to a question from Ms McKechnie on whether there were limits to the accumulation of large blocks of leave and the periods for which these could be carried forward, Mr Clementi acknowledged there was a problem. The Bank had a very generous flexitime system. Mr Footman commented that this was the biggest single issue. If flexitime were not reformed, staff would be able to take their core benefits, under the new proposals, and use the flexitime system to obtain a significant number of additional days off. In theory it was possible to reach 45 days leave.

Mr Buxton, noting the 28% cost of the benefits package, said that most financial institutions in the City had moved away from this type of benefits package some time ago. Barclays did not give any loans to staff that had a cost to the bank. There were practically no financial organisations in the City giving BUPA to pensioners. It was being phased out for past pensioners of Barclays and had been stopped for new entrants. Mr Clementi noted that the Bank had also stopped entitlement to BUPA after retirement for new entrants joining after November 1997. Mr Buxton said he believed the Bank should be very much more aggressive in cutting out subsidised schemes such as educational loans and BUPA membership for pensioners and should move all the loan schemes to commercial terms, perhaps discounted, but at no cost to the Bank. It should use some of the 28% cost of benefits to raise salaries.

Mr Davies said that the FSA had been forced down the same track because it had found all kinds of exotic benefits packages in its constituent organisations when it was set up. He noted the difficulty of instituting a new flexible benefits package, but said that only 10-20 staff had stayed on the old terms, under TUPE. Of the 1,600 who went on to flexible benefits, only one staff member had reconstructed them exactly to the previous pattern. So there was a potential welfare benefit. The issue of flexible benefits had now disappeared off the FSA's radar screen.

He also drew the Bank's attention to the attitude of the Contributions Agency to flexible benefit schemes. The issue was how schemes converted into cash were treated from the National Insurance point of view. The FSA had been at the leading edge on this. Mr Davies also suggested that the Bank should be more robust in the way it presented its flexible benefit proposals to staff in the initial stages.

Mr Bailie said he was uneasy about taking benefits from pensioners and he believed that this might rebound on the Bank. Mr Clementi said it was not possible just to withdraw, and there would have to be negotiations. Mr Buxton said that if pensioners had a legal right to the benefit then it should not be withdrawn.

Mr Morris commented that the process had to be managed sensitively. He said he was critical of the suggestion in the last paragraph that the proposal was not orientated towards costs reductions. He did not believe the Bank should have to apologise if it were cost reduction orientated. Benefits amounting to 28% of salary were totally out of proportion and not defensible outside the Court room. Court had heard earlier about difficulties in recruiting. There should be a clear strategy that the Bank should shift some of its costs from benefits to recruiting. The whole question of entitlement had to be reviewed. The benefits package had grown to be a right rather than discretionary. A culture of expectation had grown and that had to be shifted. He noted that the first thing he had done when appointed General Secretary of his union was to sell the mortgage book that the union had operated since 1922 to a commercial organisation.

He understood Mr Bailie's point about health insurance for the retired, and there should be consultations. But health insurance into retirement was unique. An option was to pay a one-off cost to get rid of it. He proposed a benefit strategy that would support recruiting and retention of staff and move away from benefits as of right.

Mr Neill said that he would be very tough about terms, going forward, and would buy out inappropriate practices. Those who did not support such a move would leave. He supported flexible benefits. Sir Colin Southgate noted that 20% of the 28% value of benefits was pensions so that the discussion referred only to the remaining 8%. Mr Footman agreed.

Dame Sheila Masters noted that Court supported the review of benefits and if anything would encourage Mr Clementi to go further.

Report on progress on the Working Time Directive (Messrs Vickers, Clark and Footman in attendance)

Mr Footman noted that the Directive had come into force in October. Thought had been given to how it applied to the Bank. There were quite small but important areas where working weeks were more than 48 hours. A large percentage of those were at the very top of the Bank but there were hot spots lower down. The former was a cultural issue, while the latter was a management problem. He noted that there was an exemption in the Directive, aimed at Chief Executive and similar functions where people determined their own times. The Bank had decided that this would include Governors, Directors, Deputy Directors and members of the MPC. Heads of Division had then been asked if they were prepared to disapply the Directive if their hours were monitored. The HoDs had agreed to do that and had signed waiver agreements. For the rest of the Bank, there would be careful monitoring, and if an average of more than 48 hours per week was worked over a 17 week period there would be discussions with management. If the working time were embedded in the job, then the staff member might be asked to sign a waiver. Otherwise the intention was to change the job.

Appointment to Head of Division (Messrs Vickers, Clark and Footman in attendance)

Mr King reported that in accordance with 'Matters Reserved to Court' he would like to announce a change at Head of Division level. Creon Butler had been appointed to the post of Chief Economist and Head of the Economic Relations Department at the Foreign and Commonwealth Office and had resigned from the Bank. He would be succeeded as Head of Monetary Instruments and Markets Division by Roger Clews with effect from 19 April.

Court in Birmingham (Messrs Vickers, Clark and Footman in attendance)

Mr Clementi confirmed that the Court meeting scheduled for 19 May would take place in Birmingham on the premises of the Bank's Agency. It would commence at 11.00am, having been preceded by coffee at around 10.30am, and would be followed by a buffet lunch. Mr Clementi agreed that Members of Court would be given lists of Mr Beverly's guests at the lunch in advance.

Annual Report
(i) Draft Executive Assessment of the Bank's Performance
(ii) Draft Report on the MPC
(Messrs Vickers, Clark, Footman and Berkowitz in attendance)

Mr Footman introduced two draft papers he had produced for inclusion within the Bank's Annual Report. The first related to the Executive's review of the Bank's performance against its 1998/1999 objectives, and the second was the Report on MPC Procedures. He noted that the Report on procedures might need to be changed in the light of the three papers presented to Court on the subject that morning. He also noted that the Executive review followed the template he had offered to Court in January. It was in narrative form, but could quite easily be turned round to have a greater degree of judgement and assessment in it. The review of MPC procedures closely followed the notes to Court from Mr Tucker, Mr Allsopp and Mr Jenkinson.

Dame Sheila Masters said that in her view there was too much description and not enough judgement and appraisal in the Executive assessment. Mr Neill agreed and gave an example of page 7 where he believed that the objective of increasing public understanding of the MPC had not been demonstrated in a convincing way. Perhaps the Bank should carry out measurements on its target audiences. Dame Sheila Masters commented that the individual Executive reports, on which the Executive assessment drew, shied away from judgements. It was at that level that the flaw existed, and Mr Footman had worked with what he had been given.

Turning to page 6 of the Executive assessment, Sir David Lees noted the comment that the new International Economic Assessment Division would be responsible for the analysis of the economic consequences of EMU, and the economic arguments for and against the UK joining the euro area. He asked whether this was for internal use or for publication. If published, it would be seized upon, and care would be necessary.

Mr King said that when the time came to assess the Chancellor's five tests for membership, he expected that the Bank would be asked to give a public view. It was inconceivable that the Governor would not make a speech on that point. The Bank needed to be capable of providing advice on whether the tests were met or not. Sir David Lees said it was a question of whether the tests were sufficiently comprehensive. Many people would be advancing economic arguments for and against. There were dangers in that area. Perhaps the wording could be changed after further reflection.

Dame Sheila Masters asked for more detailed comments to be sent to Mr Footman. She asked Members whether they had any general points to make on the Monetary Policy Committee procedures paper. None were made.

She also asked whether there were any general points on the Executive review paper. In reply to Mr Stretton, Mr Footman said that the review of the earnings data was mentioned in the context of the recommendation for a Service Level Agreement between the Bank and the ONS. Dame Sheila Masters noted that the problem was now out in the open. One side of the question was whether the MPC got its judgement wrong. The question for Court was how the Bank responded when it became aware of concerns about the series.

Mr King suggested that the Report could point out that one of the data series was suspended for part of the year, that the MPC obtained data from other sources and that the series was back in publication. The report could then refer to the Service Level Agreement. Sir David Lees said that was an important point, because if would allow the Non-Executives' report to cross refer to it. Otherwise, NedCo might have to cover the point in its own report. Mr Neill agreed that an explanation would be helpful. Ms McKechnie said that the point to make was that the Bank was now seeking a Service Level Agreement in response to what had happened. Mr Allsopp was worried that too much might be reported on this one issue. He suggested that it should be put forward as an example of an incident that led to procedures being put in place to put it right, rather than describing the episode itself in the Annual Report. It was an example of how the system responded, and as such it would defuse a lot of criticism.

Ms McKechnie said that the references to regional information might be regarded as patronising in the North East. Mr Footman said the reason the references were there was because of the Act. Mr Allsopp agreed with Ms McKechnie that the reference to setting a single interest rate gave a misleading impression. Sir Colin Southgate said the report could show at this point where the Agents were based. He preferred to take out the reference to the South East in the passage concerned. Sir Chips Keswick believed that there was too much explanation in the review of why the Bank had lost functions, such as the issuance of debt.

Dame Sheila Masters said she looked forward to seeing a revised version of the papers at the next Court meeting.

Dame Sheila proposed deferring the discussion of counterfeiting until the next Court meeting because of lack of time.

Court Succession

Dame Sheila reported that at a meeting held with the Governor before he went on holiday, he had asked her to seek Court's views on potential candidates for membership of Court later this year. Dame Sheila noted that the position was a little confused. Mr King had told her that the Bank would be obliged to advertise Court appointments in line with Nolan practice for the Public Sector. Names were being sought with a view to encouraging them to come forward. The Governor had identified manufacturing, retailing and telecommunications as sectors where Court should have representation or increase its representation. She asked Members of Court to forward suggested names to her or the Governor. Sir Chips Keswick said he believed that Court was under-represented internationally. Dame Sheila Masters said she did not rule out international representation.

Court was up.

Sheila V Masters

Peter Rodgers 21.4.99

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 APRIL 1999

Present:

Mr George, Governor

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Stability

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Allsopp

Mr Bailie

Mr Buxton

Mr Davies

Mr Hawker

Mrs Heaton

Sir David Lees

Ms McKechnie

Mr Morris

Mr Neill

Sir Neville Simms

Sir Colin Southgate

Mr Stretton

The Minutes of the Court of 17 March, having been circulated, were approved.

The Governor said that to his very great regret Sir David Lees and Sir Colin Southgate would be stepping down from Court at the end of May on completion of their second terms. He expressed his sincere appreciation of what they had done and were still doing over their eight years on Court. He noted that there would be an opportunity to thank them properly at a farewell dinner on 23 June. He also noted that the Chancellor had agreed to reappoint Sir Neville Simms, Mr Allsopp and Mr Davies, and the Governor said he was delighted about that.

Two new Directors of the Bank were being sought with effect from 1 June, and as Dame Sheila had mentioned at the previous Court, it was necessary to go through the Nolan processes. With that in view, an advertisement had appeared that morning on page 43 of the Financial Times for two new Non-Executive Directors, and a Treasury press release would be put out shortly.

Turning to procedures, the Governor said that anyone could nominate anyone else, as well as themselves, in an application. There would be pre-sifting of applications and a list of about 30 would be shown to himself and the Chancellor. At that point the list would be reduced to about six, recommendations would go to the Chancellor and the Governor would have the opportunity to comment on them.

The Governor also noted that the Chancellor had concluded that he could not agree to fees of more than £5,000 per annum for Non-Executive Directors of the Bank; and £7,500 for the chairman of the sub-committee of non-executive Directors. The Governor had promised the Chancellor he would put that figure to Court. He noted that he had told the Chancellor that he would encourage Directors to claim for expenses, and the Chancellor replied that that was absolutely reasonable. He had also told the Chancellor that he would encourage Directors to take advantage of the arrangement by which once in each term of office the Bank paid for a charity event in the Court Room. He commented that Mr Bailie's event for the Samaritans the previous evening in the Court Room had been a wonderful occasion. Such events made use of the facilities of the Bank and were very helpful in bringing people associated with charities into the Bank.

Court was content with the proposals on salary, expenses and the use of the Court room. Mrs Heaton and Mr Davies noted that in their experience the process of advertising for board members under the Nolan guidelines had thrown up a number of good candidates.

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MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Vickers and Plenderleith, Sir Alan Budd and Professor Willem Buiter in attendance)

Introducing the discussion, Mr Vickers drew attention to the minutes of the April meeting, the vote of 8-1 in favour of a cut of 0.25% (with Professor Buiter being in favour of a larger cut of 0.5%) the continued strength of sterling and the labour market data. He also noted the 0.5% reduction in interest rates by the European Central Bank.

The international highlights were still strong domestic demand in the US, the striking contrast between lower business confidence and quite buoyant consumer confidence in Euroland, continuing weakness in Japan and a fall in spreads for emerging market debt.

Turning to the UK, Mr Vickers noted the first quarter survey by the British Chambers of Commerce which showed a recovery, from a low base, across all sectors, and he also drew attention to the housing and car markets. The week of the Court meeting was a busy one for data, with producer prices, retail prices, labour market statistics and – later in the week - retail sales, money figures and the first quarter preliminary estimate for GDP. Discussing earnings growth, Mr Vickers noted that the ONS was now asking a more general question about bonuses which caused a break in the series, and disentangling bonuses from regular pay was therefore a difficult issue. He noted that Court had been promised a paper on earnings, and while there were still more difficulties to untangle, the paper might perhaps be brought to Court in July.

Mr Plenderleith, commenting on the markets, said that sterling had appreciated for two years until the summer of 1998 when it had peaked at 109 on the index. During the remainder of the year it eased to about 100. This was explicable in terms of the slowing of the economy. But since the turn of the year sterling had risen steadily to about 106-108 on the index, and against the dollar was now at $1.61, and against the Euro was now at 0.66, the equivalent of about DM 2.97. It was hard to explain these movements, which had occurred despite substantial interest rate cuts. Part was the weakness of the Euro, which itself might partly be linked to events in Kosovo, and certainly to the weaker performance of some of the larger Euroland economies and also to strains in policy making in the Euro area. Sterling had also been affected by purchases connected with mergers and acquisitions, though these deals were not all one way. The strength of sterling appeared also to be related to growth prospects, rather than to interest rate relativities. The UK was going through a trough without too much damage and with the prospect of a pick-up, so that sterling was an attractive place to put funds. In the domestic markets, looking at the interest rate curve, markets had begun to think, since the most recent reduction, that rates were at or close to the bottom of the cycle. They perceived the possibility of further easing, but expected the prospect afterwards to be one of tightening. Therefore the first indication of acceleration in growth or a pick-up in inflation, or a combination of the two, was likely to lead the markets to proceed on the basis that the next move in interest rates would be up.

Mr Buxton noted that business confidence was higher. This was because the economy had stopped going down rather than because it was improving. Business problems had stabilised since the end of last year, and he also noted that the percentage of non-personal accounts in credit, at 80%, was the highest for 15 years. He drew attention to the importance of the out-turn in the US.

Mr Neill said that the retail car market was very difficult to interpret because of the change in registration number date and pre-registration by manufacturers. March showed a spectacular increase of 95%, largely because it was the new registration month, but it was interesting to note that the out-turn for the quarter as a whole was 2.1%, compared with industry expectations of a fall. In April the markets had started very hopefully. Mr Neill noted very heavy pricing pressures on manufacturers.

Sir Neville Simms said that in the construction industry in March confidence had fallen, but it had begun to pick-up. The fall in confidence had been due to very large fluctuations in orders compared with previous years, and it was not suprising that while workloads were still buoyant, people were worrying rather more about next year. He expected a soft landing and growth to be resumed after a hiatus of 6 to 9 months.

Mr Bailie agreed with Sir Neville. He also said the view was great gaining ground that the level of the exchange rate was a given fact, and business had to get on with it. On this view, previous profits - when the exchange rate had been lower - were a windfall, and the only way to deal with the pound was through productivity improvements. That could only be good in the long run for the economy. He also noted the risks to the US economy.

Mr Morris said he did not detect any significant shift in earnings growth compared with the previous month, and he asked whether there was any information on the impact of the minimum wage now that it was a reality. Mr Vickers said hard data were difficult to come by and he did not expect the Agent's contacts for the most part to be affected. There were a number or reports of anticipatory pay increases, but at the same time some settlements seemed to have been deferred. There was not yet a very clear picture of the extent to which pay rises had been in anticipation of the minimum wage and the extent to which they had been the result of a consolidation of non-wage benefits.

Mr Allsopp drew attention to the international risks, and noted that the UK for its part seemed to be proceeding rather as forecast, with a flat first half and hopefully a pick-up in the second half. He noted the widespread focus on the risks of a slowdown in the United States which would have to be offset by an up-turn in Europe. But there were questions about whether the European Central Bank was behaving in a way that would ensure that that upturn would occur.

The Governor noted the half percent ECB interest rate cut the week before. Sir David Lees said that his experience with two particular companies was that performance in Continental Europe was less than expected. Mr Stretton said he had been very surprised by the strength of long term savings.

Commenting on international issues, Mr Vickers said that the Bank was very much alert to the risks. The best realistic case was that the US would return gradually to trend and the question then was not just whether Euroland but Japan, too, would off-set that. In Italy, the picture had been grim for some time, in Germany there were cost pressures and poor levels of business optimism, although in France the situation was a little better.

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MPC Procedures (Messrs Vickers, Plenderleith, Footman, Berkowitz, Sir Alan Budd and Professor Buiter in attendance)

Introducing his paper on ad hoc meetings of the MPC, Mr Vickers said that it might be produced in future on a quarterly basis. There were three broad headings of ad hoc meetings attended by MPC members. First, there were procedural meetings considering issues such as the structure of the pre-MPC meeting; second, there were meetings on research work in the Bank; and third, there were other meetings such as the one held to discuss the transmission mechanism paper which would be released towards the end of the following week. This paper had been prepared at the suggestion of the Treasury and House of Lords Select Committees. The models book would be released at the same time and both would be made available to Court.

Dame Sheila Masters said Mr Vickers had been asked to prepare the paper so that NedCo could have a complete view of what the MPC looked at outside the monthly and quarterly rounds. If individual members of NedCo wished to know more about particular issues they could ask.

Professor Buiter noted that as well as the meetings reported in the paper, individual members of the MPC went on a significant number of visits, and the paper did not represent all the activities of MPC members. The Governor commented that this was a significant point, because MPC members had a very important job in visiting and speaking in the regions and meeting groups of industrial people. This was very helpful in getting across the message of what the MPC sought to achieve. Mr King noted that a list of all the meetings the MPC attended would be very much thicker.

Mr Morris asked whether any of the papers for the meetings on Mr Vickers' list could be made available to Court on request. The Governor said by all means members of Court could ask, and if there was any difficulty in providing the papers the Bank would explain why.
Mr Vickers agreed to arrange for Mr Morris to receive papers on the working families tax credit as soon as they were available.

9

FINANCIAL STABILITY ISSUES

Developments in International Markets (Messrs Vickers, Clark and Plenderleith in attendance)

Mr Clark said that in emerging markets generally there had been a material improvement in the last month, both in sentiment and in fact. Spreads on debt, at 800-900 basis points on average, were about half of their peak, and the lowest since the Russian crisis last summer. At the same time, there had been a general strengthening in equity markets. There was also some improvement in growth prospects.

Turning to specific cases, Mr Clark said the situation in Brazil was turning out better than some had feared, with the pass-through of the Real depreciation to inflation less than expected. At the same time the exchange rate had risen, and Brazil was also contemplating a bond issue later in the week. In Asia, there were signs of recovery, though with important exceptions, notably China and Indonesia. Russia was now quite likely to default on some of its sovereign obligations.

Mr Clark noted that a week earlier, the first meeting of the Financial Stability Forum had taken place in Washington, and Mr Davies and Mr Clementi had attended. The first meeting of the Interim Committee Deputies had also taken place in which Mr King had taken part. It looked, inter alia, at proposals for a new financing facility, to try to handle liquidity problems of emerging markets in advance. Sir Colin Southgate said he had met the Brazilian President at the CBI, and he had been very positive and was pushing hard for the idea of a fund to prevent liquidity problems. The President also believed that one of the reasons inflation had remained lower than expected was that consumers in Brazil were accepting the message that they did not wish to have high inflation. Mr Clark noted that Brazil appeared to be making some progress in stretching the maturity of its debt. The Governor said that he had spoken with President Cardoso, who had taken on board the need for a new nominal anchor, and was very keen to move to an inflation target. The Governor said he disagreed with the view that Brazil would have been helped if it had had more money from the IMF sooner. He believed it would have spent it protecting the exchange rate.

Mr Allsopp commented that he saw a mood of improvement in the international financial environment, but he noted the risks associated with the deterioration of the US balance of payments. That would slow the rest of the world. Mr Clark noted that the IMF's latest world economic outlook did include a forecast of a US slowdown. Mr King said that the issue for some time had been that, if there was a slowdown in the US, it might be delayed, and if so it would bring a chance of faster demand growth in Europe and Asia. The G7 Deputies had been briefed by the Fund, which had said prospects were a little brighter. The US representatives had asked what Europe would do about domestic demand on the continent.

Mr Davies, commenting on the Financial Stability Forum in Washington, said it comprised the finance minister, central bank and lead national regulator of each country. Only in the UK and Japan did the decision on who came as national regulator not cause inter-necine warfare. Some countries had made major changes that improved financial oversight, including Japan and Korea, but in others not a lot had happened yet. He noted that the Forum had set up three groups, on highly leveraged funds, which he chaired, on off-shore centres, and on issues surrounding short-term capital flows.

FINANCIAL MARKET OPERATIONS ISSUES

Executive Report

Mr Plenderleith reported two items to Court.

(i) Work on the adaptation of systems to make them Year 2000 compliant in the financial market operations area was substantially complete. The target had been to complete all the work by the end of 1998, but some had been deliberately deferred until the end of the first quarter of 1999 because in doing so the Bank could also combine it with euro preparations work. More than 100 critical systems had been examined and cured. The Bank's part of Target, CHAPS Euro, was compliant, but Target itself would not be compliant until October as a result of an ECB decision on timing. The Bank of England's operational areas would maintain a software moratorium (with changes permitted only in very restricted circumstances) from September until March next year, and in the meantime it was preparing contingency plans and was planning its activities over the New Year weekend. In conjunction with Mr Clark's side of the Bank, work was in hand on the market behaviour that might occur over the millennium period. Overall, the information technology work was now substantially complete. In response to a question from Ms McKechnie, Mr Plenderleith said that the Bank was planning to obtain assurances from utilities that their services would be available after the millennium weekend.

(ii) Mr Plenderleith reported to Court that the new £20 note would be put into circulation on 10 June, and a copy of the note was circulated to Court Members for inspection. Mr Plenderleith described the security features of the design, and he also said that a new £10 note would be issued next year. [In response to a question from Dame Sheila Masters, Mr Plenderleith said that there were arrangements for early numbers of the new note to be made available for purchase.]

MANAGEMENT OF THE BANK

Quarterly Financial Report (Messrs Midgley, Clark, Plenderleith and Vickers in attendance)

Mr Midgley noted timing issues that distorted the quarter by quarter trend in the figures, and he said that the quarterly numbers were clouded by the cash bonuses paid in Q4. The year as a whole, however, displayed a much more familiar and coherent picture. Supervision & Surveillance stayed in the Bank two months longer than expected, leading to an increase of £3.5mn in Bank spending. But the rest of the Bank was underspent by a similar amount, except for legal fees, which were £1.75mn higher, because of BCCI and Spens. He also noted that expenditure on refurbishment of £2.5mn had been deferred into next year. Taken together the changes came to £1.5mn, relative to the budget.

On the income side, there were no real surprises. With the transfer of S&S delayed and CRDs remaining higher for longer, there was more income than in the budget and that was worth about £20mn. In reply to a question from Sir Colin Southgate, Mr Midgley said that the higher than expected legal fees were a result of unpredictable timing of court cases.

[redacted]

The 1999 Annual Report – in Draft. (Messrs Clark, Plenderleith, Vickers, Midgley, Berkowitz and Footman together with Mrs Bishop in attendance)

Mr Clementi drew Court's attention to Section 2, which it had not seen before, and to the new design. Mr Footman described the other sections, including the Bank's financial framework, where there had been a significant change, picking up the point made by Mrs Heaton at the previous Court about the apparently small proportion of the Bank's costs that supported the Monetary Policy Committee. The answer to this was shown in a pie chart of the budget in functional terms, on which basis 26% was allocated to Monetary Policy. He also noted that Section 8 had not been circulated before. Some parts of it would otherwise have been in the Director's Report. Turning to the Remuneration Report, in Section 9, he noted that the Audit and Remuneration Committees had seen it, but there was an outstanding issue relating to service contracts for Governors. Mr Footman noted that the accounts would be presented to the Court meeting on 11 May.

There were no comments on Section 3.

Commenting on Section 4, Mr Neill advised that the remarks on internal preparations for the Year 2000 should be written in a much more positive way. The Governor said that would be taken on board. Mr Footman agreed with Dame Sheila that a form of words should be found at the end of Section 4 to say that the Bank had met its budget for the year. The Governor and Dame Sheila agreed with Sir David Lees that the wording on page 8 of Section 4 - "a great deal remains to be done in this area" - was rather weak, and should be strengthened. Sir David also proposed a rewording for greater clarity, of the last 3 lines on page 21, particularly the words "more than offset by reduced spending on other activities".

Turning to Section 5, Dame Sheila asked whether there might be an over emphasis on the role of regional information and the Agents. A contrary view was taken by the Governor, Mr Plenderleith, Mr Hawker and Mr Buxton. Mr King said it was important to be careful about how the activity was described. The Bank went to the regions to build a better collective picture of the economy as a whole. He did not wish to draw attention in the Annual Report to one statistic, such as regional unemployment, because that gave the impression that differences across the regions could be a driving force, which was a hostage to fortune. Mr Allsopp and Mr Buxton agreed that, if anything, there should be more emphasis on the extent to which members of the MPC made visits around the country. In response to a question from Mr Morris about sectors of the economy experiencing extreme difficulties, the Governor said that this was a powerful point, and he hoped to include it in his own foreword, which would be circulated to Directors in draft. The Governor also agreed that there would be a very careful look at the section on the Agents.

Turning to Section 6, Sir David Lees said that in paragraph 2, line 3, objectives and strategy were put the wrong way round. The Governor agreed with Sir David. Mr Berkowitz noted that the core purposes and objectives, taken together, comprised the objectives and strategy for the purposes of the Act. The Bank had tried to avoid correlating directly to the Act, and had bundled the points together, because that was what was required by the Act. The Governor commented that he saw merit in reversing strategy and objectives in line 3, even though this was the order in the Act. Sir Colin Southgate said Court should be trying to correct the order in the Act. The Governor also agreed with Sir David Lees that the word "continue" should be inserted in objective 2 so that it read "to continue to build public support for price stability". Mr Buxton said he would expect objectives and strategy to be Section 1 not Section 6. The Governor said the Bank would reflect on that.

Turning to Section 7, the Governor agreed with Sir David Lees that the word "current" was redundant in the phrase "current operating expenses". Sir David made a number of other drafting suggestions for Section 7 with which Mr Midgley agreed. Following a further discussion of points raised by Mrs Heaton about the introduction to Section 7, the Governor agreed that the introduction would be looked at again. In response to a question from Sir Colin Southgate, Mr Clementi said that the provision for decommissioning some of the Bank's buildings was £10 mn and it was proposed to maintain that, subject to the views of the Audit Committee. Following a discussion of the chart on page 4 of Section 7, the Governor commented that he believed the chart showed what had happened extremely well, and that the Bank would look at a suggestion by Sir Colin Southgate that it should be moved onto the first page.

Turning to Section 8, the Governor said he took a point made by Mr Buxton and Sir David Lees that the cost of community secondments and subsidised accommodation should be added to the figure for community programme contributions in the first line. In a discussion of staff numbers, Mr Footman agreed that, presentationally, it might be worth mentioning the net increase of 13 in Monetary Analysis staff, alongside the increase in staff working on projects related to the introduction of the Euro and preparation for the Year 2000. Mr Clementi suggested that it might be useful to include comparative figures for mid-career staff recruitment to offset the impression given by the fall in graduate recruitment, which had been pointed out by Mrs Heaton.

Turning to the Remuneration Report, Sir Colin Southgate said he preferred the original version of the paragraph on service contracts, but with the deletion of the words "and the terms of their employment contain no provision for compensation on early termination of employment". Mr King noted that the concern was that if any payments were made to the Governor and Deputy Governors on leaving the MPC, to compensate them under Purdah arrangements agreed with the Bank for delaying taking up new employment, there could be criticisms that this had not been flagged in advance. It would be better to explain any such payment as a matter of general principle, rather than as an adhoc payment to a particular individual. Sir Neville Simms agreed with Sir Colin that the Bank had a governance body which should do the job of agreeing any such payments at the time, and judgements should not be made of what it might do in the future. Mr Berkowitz noted that Court had adopted a policy under which, in these circumstances, compensation would be paid. Whether it was a contractual entitlement was more debatable, particularly where the Governors were concerned. Sir Colin Southgate said that most organisations would address the issue of gardening leave at the time a person left. The Bank had a way of doing that, through RemCo to Court.

The Governor concluded that his sense of the discussion was that Court supported Sir Colin's proposal of using the original paragraph, with part of the first sentence dropped, so that it would now read "The Governor and Deputy Governors do not have service contracts with the Bank. Governors are required to provide services only to the Bank. With Court's approval other directorships relevant to the Bank's work may be accepted but any fees must be paid to the Bank".

Sir Colin Southgate said that he saw no reason to disclose the salaries of Mr Plenderleith and Mr Vickers because the Bank was not legally obliged to do so. Mr Plenderleith, declaring an interest in the point, said he would be concerned if his salary were not disclosed, because he would hate to find that an issue which attracted attention. It would mean that seven members of the MPC had their salaries disclosed and two were not disclosed, a distinction which might attract needless attention. The Governor commented that the Bank did not have to disclose MPC salaries at all, but if it did, he could see an argument for including Mr Plenderleith and Mr Vickers. Many people were interested and his view was that Mr Plenderleith's point stood. Since the two individuals were relaxed about the point, he suggested their salaries should be disclosed, and he was sure they would be grateful to Sir Colin for raising the point on their behalf.

In response to a question from Mr Stretton about whether it was correct that the Governor was accruing retirement benefits under a defined benefit pension scheme, the Governor said that perhaps the Audit Committee could look at the point.

Sir Colin Southgate drew attention to the issue of whether the cost of life insurance for the Governor should be included in the emolument tables as a benefit. The Governor agreed with a suggestion by Sir David Lees that rather than have a long discussion in Court this should be put to Audit Committee the following week. Sir David said he would ensure that Sir Colin Southgate was kept fully in the picture, as Chairman of the Remuneration Committee.

Mr Neill drew attention to the one percentage point fall to 95% of bills paid by the Bank on time, which he noted was a politically sensitive issue. 95% was a high figure and this should be emphasised. The Governor said the point would be looked at, and the Bank would consider it and come back with a suggestion.

A Report from the Chairman of the Audit Committee (Messrs Vickers and Berkowitz in attendance)

Sir David Lees said that the meeting of the Committee covered the main points of principle in the Bank's accounts. It also looked at the NMB accounts because the Committee was also Audit Committee to NMB. The accounts were satisfactory. The Audit Committee, with Mr Clementi's blessing, was urging the Bank to see if it could find a way out of NMB by selling the residual assets. If the Bank could get a good price in the light of the overhead costs of running down NMB, it should continue to seek to sell it.

Turning to Year 2000 issues, Sir David noted a very good presentation to the Audit Committee by the Bank and he said progress was very satisfactory.

He noted that Mr Clementi had asked the Committee to be involved in Head Office refurbishment and there had been a talk to the Committee on the Project. A number of issues arose from that and the Audit Committee would continue to look at the project. He drew attention to pages 5 and 6 where there were a number of issues on which the Audit Committee had asked for decisions by management. On page 8, there were comments on the risk matrix, which was now highly developed, and he suggested that this might now be circulated to all Non-Executive Directors since it had become a very comprehensive document. The Governor thanked Sir David and the Audit Committee for the work they had done on Court's behalf.

The Houblon-Norman Fund Report & Accounts (Messrs Berkowitz and Vickers in attendance)

There were no questions on the Houblon-Norman Fund Report and Accounts.

Matters reserved to Court (Mr Berkowitz in attendance)

Mr Berkowitz said that the existing Matters Reserved to Court had been updated and extended to cover the 1998 Act. Among the changes, the delegation of Executive powers by Court to the Governors had been made express, whereas before it had been by implication. Dame Sheila Masters said she had seen the drafting comments, and the document seemed to her a sensible updating.

Court approved the revised version of Matters Reserved to Court.

Court was up.

11 May 1999

A COURT OF DIRECTORS AT THE BANK

TUESDAY 11 MAY 1999

Present:

Mr George, Governor

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Stability

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Allsopp

Sir David Cooksey

Mr Hawker

Sir David Lees

Ms McKechnie

Mr Morris

Mr Neill

Sir Neville Simms

Sir Colin Southgate

Mr Stretton

The Minutes of the Court of 21 April, having been circulated, were approved.

THE BANK'S REPORT AND ACCOUNTS IN DRAFT TOGETHER WITH A REPORT FROM THE CHAIRMAN OF THE AUDIT COMMITTEE (Messrs Smith & Higgin of PricewaterhouseCoopers together with Messrs Midgley, Clark, Plenderleith, Vickers, Footman, Berkowitz and Darbyshire in attendance)

The Governor said that he had asked Peter Smith, the Senior Partner at PwC responsible for the Bank's annual audit together with his fellow partner, Michael Higgin, to join Court for this item. Copies of the draft financial statements for Banking and Issue Department had been circulated together with the draft report, having taken on board comments made at Court on 21 April.

The Governor asked Mr Clementi to introduce the Report and Accounts in draft. Mr Clementi noted two small adjustments that had reduced the profit by £3mn to £172mn compared with the figures given at the previous Court meeting. He also noted that the main changes in the footings were in respect of the Target system, an issue which was familiar to Members of Court. He said discussions continued with European counterparts to see if it was possible to achieve a proper netting arrangement by the year-end. Mr Clementi further drew Court's attention to the £64mn received from the liquidation of the European Monetary Institute of which £25mn went into the cost of the Bank's contribution to the European Central Bank. The net sum was shown as a receipt. Turning to provisions of approximately £14mn, much the largest part was the release of provisions for NMB. Mr Clementi reported that the Bank had had an approach from an outside party interested in the possible acquisition of NMB and was following this up. In principle the Bank would like to sell NMB, subject to receiving a fair price and proper arrangements for staff. A report would be made to Court next month.

Mr Clementi reminded Court that a retrenchment provision of £10mn had been set up a year ago for the cost of de-commissioning buildings, not for refurbishment of the Head Office. A certain amount of the provision would be used this year but the lion's share would be next year.

Mr Clementi drew attention to the five occasions in the Report when Directors were specifically referred to. In relation to the draft document before Court, he said these were Note 1a on page 6, Note 1d on page 7, Note 11 on page 14, Note 12 on page 15 and Note 24 on page 23. Finally Mr Clementi drew attention to the Letter of Representation, which he believed was a fair letter to send.

Sir David Lees, Chairman of the Audit Committee, noted changes in the disclosure of Directors' emoluments. There had been a technical difficulty with respect to the life assurance premium paid on behalf of the Governor. It had finally been possible to find a way through that maze after many hours of looking at alternatives. A method had been found which would not require disclosure, and he understood the auditors were happy with that. The Audit Committee was content with the Accounts as drafted and commended them to Court.

Dame Sheila Masters noted that the Report and Accounts used the terminology "opinion of Directors" but under the new Act, Directors referred to non-executive Directors and the Governors were referred to separately. The Report and Accounts had failed to catch up with the terminology of the rest of the Annual Report. Mr Darbyshire noted that this had been put right in later drafts, which referred to the opinion of the Court of Directors. The Governor noted that Court would have the opportunity to satisfy itself about the language before the Annual Report was signed off the following week.

Mr Higgin reported that the Auditors had obtained all the information and explanations required for the Audit, and had received the full co-operation of management. The Audit was virtually complete, with the exception of a few minor points which had to be tracked through to the proofs of the Report. Subject to the minor points, the Auditors would sign an unqualified opinion in the form Court had before it. Turning to the management letter, Mr Higgin said that based on the scope of the work the Auditors had done with the Audit Committee, they were not aware of significant weakness or breakdowns of controls affecting the financial statements which would need to be brought to Court's attention at this stage. The Governor expressed his thanks to Messrs Smith and Higgin and also to Sir David Lees and his Audit Committee team.

Sir David Lees asked whether the words "objectives and strategy" were used the wrong way round in the Report. Dame Sheila said that this phrasing was a direct lift from the Act of Parliament. Mr Berkowitz said that the Act mentioned objectives and strategy in that order. It had been agreed that it was not necessary to put a label saying which was which, but rather the Bank should say that these taken together comprised the objectives and strategy for the purposes of the Act.

A number of suggestions were made by Members of Court for dealing with this difficulty of terminology. The Governor said that although it was necessary to have objectives and strategy in that order in the heading, he did not see why it could not be reversed in the text. Ms McKechnie said the purpose should be to prevent commentators suggesting that the Bank did not understand the meaning of strategy and objectives. She suggested the legal text should be used in the box at the head of the relevant sections. The Governor agreed with Ms McKechnie's suggestion and asked whether Court was content with it. Court was content.

Mr Footman noted comments from the Treasury on the Report and Accounts. The Treasury had asked if a clearer description could be given of the role of the Treasury Representative. The Governor said that was entirely reasonable. The Treasury had also asked whether in Section 7 it could be stated that the investment of CRD balances were currently yielding more than £66mn suggested by the current text. Court agreed with the suggestion from the Governor that the Bank should be left to deal with that point. Finally, the Treasury had noted that it was pleased to see fuller information provided in the Report, notably on the Bank's expenditure and related matters.

In response to a question from the Governor, Mr Midgley said that before the Bank of England Act 1998, the Chief Secretary to the Treasury wrote to the Governor saying he would like a line in the Accounts showing the profit and loss on foreign exchange transactions in the context of intervention or other activity. The Governor had written to the Chief Secretary agreeing. The Treasury had reminded the Bank last week of this correspondence. The Treasury had been told that there was nothing material to report in the year just finished. Mr Midgley believed the Treasury was content with that reply.

Sir David Lees, turning to the Audit Committee reviews of the effectiveness of the systems of internal control, said that PricewaterhouseCoopers had written to confirm the view that the Bank was in a position to include a statement in the Annual Report

Sir David Lees noted that one area the Audit Committee felt Court should now be involved in was IT, which had clearly been under some pressure with the Millennium, Euro-conversion and other tasks. It would be helpful if Court could receive, at a convenient time, a paper on IT strategy within the Bank, which would inter-alia pick-up the issue of resources. The Governor thanked Sir David for his suggestion and said the Bank would benefit from Court's reaction to a report on its IT efforts. Mr King noted that Court would see an IT strategy paper in relation to MA in June. The Governor noted that the wider IT paper would subsume this issue. The Governor agreed with Mr Morris that the IT strategy paper should not just be descriptive but should look to the future.

The Governor noted that the Report and Accounts would lie before Court until 19 May. Court would then be asked formally to approve the Accounts, and to give permission for them to be printed, for the Letter of Representation to be signed, and for the final payment, in lieu of dividend to be made to HMT next October. It was intended to publish the Report and Accounts on 26 May.

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REPORTS OF THE TRUSTEES OF THE COURT PENSION SCHEME

Turning to two reports from the Trustees of the Court Pension Scheme, the Governor, having declared his potential interest in the Scheme together with those of the two Deputy Governors and Executive Directors present, invited Sir Colin Southgate to introduce the first Report which contained the following recommendations:-

(a) the annual pensions in payment to former Governors and Executive Directors and allowances to the widows of former Members of Court should be increased, with effect from 1 July 1999, by the amount of the increase in the Retail Prices Index for the twelve months ended 31 May 1999.

(b) Similar increases be granted from 1 July 1999 to:

(i) ex-gratia allowances payable to Lord Richardson, Sir George Blunden and Lord Kingsdown;

(ii) the ex-gratia payments awarded to widows of former Members of Court who retired prior to 1978 and whose allowances were based on their husbands' pensions net of commutation; and

[redacted]

(c) the annual allowance paid to Lord Richardson from the Court Pension Scheme under special arrangements which were approved by Court on 10 February 1983 be increased in accordance with those arrangements.

Court APPROVED the recommendations.

With regard to the second report, Sir Colin Southgate said that a Report by the Actuary on his annual actuarial valuation of the Scheme as at 31 March 1998 showed that the Scheme was in surplus by £4.36mn after making allowances for the benefits of members earned to date and projected future salary increases for serving staff, together with future pension increases in line with inflation. The Actuary had suggested that in the light of this surplus, no contribution need be paid for the year beginning 1 March 1998 and the Trustees had agreed with this proposal.

The Pensions Act 1995 required the Trustees, as part of the valuation process, to produce a Schedule of Contributions and to agree it with the employer. The purpose of the Schedule was to ensure that contributions paid would be at least sufficient for Minimum Funding Requirement purposes and would provide a base document from which the Trustees could monitor whether contributions were paid on time. Copies of the Schedule, which indicated a nil contribution, were made available to Court, and Sir Colin Southgate asked Court for its endorsement.

Court APPROVED the nil contribution rate.

EXECUTIVE REPORT

Mr Clementi noted that he had already reported on a potential purchaser for NMB.

Mr Clementi noted that PricewaterhouseCoopers had recommended that the Bank set up a Middle Office which would bring together risk management and control functions in Financial Market Operations, and ensure more timely information for senior management. Mr Smout had written a more detailed report on how the Middle Office might operate, and this had been looked at by the Audit Committee a week ago. The Bank was pressing ahead to set up the Middle Office, which would be headed by David Ingram. The Middle Office would report to Mr Plenderleith, and would have alongside it an Assets and Liabilities Committee, which would meet quarterly and be chaired by Mr Clementi. The Bank had undertaken to have the new office up and running in the Autumn.

Mr King noted four appointments of Agents. It had been agreed to set up a Northern Ireland Agency, beginning in January, which the Governor would open. However, it was necessary to announce the Agency beforehand. He would be going to Belfast the following Monday to announce it in the context of a speech he was giving about the first two years of the MPC. The first Northern Ireland Agent would be Mr Falls, probably the Bank's most experienced Agent, who was currently in Bristol and had previously been in Glasgow. Mr King said he was grateful to Mr Bailie for his assistance.

He noted that a consequential change was that Mr Beverly would move to Bristol in the Autumn, to overlap for two to three months with Mr Falls. Mr Beverly would be replaced in the West Midlands by Mr Bartlett, currently the Deputy Chief Cashier. Mr Chris Bailey would take over from Mr McConnachie in the South East, probably towards the end of the year, although possibly early next year. He did not expect further changes for about a year.

4 Mr Plenderleith described the Treasury and Bank announcement the previous Friday of the restructuring of the UK reserves. This had involved a decision by the Treasury to sell just over half of its gold holdings. The intention was to sell, ultimately, about 400 tonnes, to reduce the share of gold in the net reserves from about 40% to about 20%. Initially, 125 tonnes would be sold during this financial year, and the proceeds would be invested in foreign exchange. It was a simple portfolio rebalancing, on the view that 40% of net reserves held in gold was disproportionately high. On that basis the decision was perfectly sensible and a matter of prudent portfolio management. It had, however, had a large impact: this was partly because of an emotional attachment to gold, partly because the sale was unwelcome to other central banks that were also long on gold (although a number had sold covertly over the years), and partly because the market feared it could break a log jam of central bank sales. The Bank would sell the gold as agent for the Treasury through a structured programme of auctions. This was an open and orderly way of selling, and it would be staged to minimise the impact on the market.

5 The Governor said that he had chaired the Annual General Meeting of the Sports Club which had asked him to convey to Court its deep appreciation of the support Court gave to the Club.

RECENT DEVELOPMENTS AND ISSUES IN THE EURO AREA (Messrs Clark, Plenderleith, Vickers, Bailey and Ms Hammond in attendance)

In introducing the paper Mr Vickers said the issues and themes were: first, the macro-economic conjuncture and prospects; second, the Monetary Policy framework and how the ECB framework compared with the UK's; and third fiscal policy, and the position in relation to the stability pact.

Turning first to conjuncture and prospects, he noted that the US was the main engine of world demand growth, but this could not go on for ever. Japan was still mired in recession. It was necessary to look to Euroland, with its high unemployment, for stimulus. Growth there had been in the 2-2.5% range since 1994, and most forecasts had 2% in 1999 and 2.5% in 2000. There were divergences within this, most obviously between some peripheral countries such as Ireland and the major economies. Mr Vickers said net trade was a drag on growth, and he also noted the contrast between consumer and business confidence measures. Inflation in Euroland was about 1%, but higher in places. An interesting question was the extent to which that mattered, because with EMU the only way real exchange rates could change would be through inflation differentials.

Turning to the Monetary Policy framework, Mr Vickers noted the 50 basis point cut in interest rates by the European Central Bank on 8 April. The ECB had a similar basic approach to the Bank of England's, in that the primary objective was price stability, but there were several differences. The ECB set its own target. The twin-pillars of the ECB target were 0-2% inflation and a reference value of 4.5% for monetary growth. The Bank of England had one point target. Mr Vickers noted the relative benefits of range versus point targets and the differences in transparency between the ECB and the Bank of England. The ECB had a press conference while the Bank had minutes, which included publication of the votes. Sometimes the different degrees of transparency could be exaggerated.

Turning to Fiscal Policy, he noted the importance of the stability pact. Euroland was not close to balance or in surplus, but could cope with the 3% deficit ceilings if the forecasts were right.

In reply to a question from Mr Neill, Mr Vickers said that the UK had been running about half a percentage point higher on the harmonised price index, and the latest publication was a little higher because of the timing of the Budget. He noted that the harmonised index had not completely settled down because of questions about the treatment of housing costs. Mr Bailey noted that as things stood the UK would under the Maastricht Treaty qualify for monetary union in relation to the harmonised index, and that had been the case for quite a while.
Sir David Lees noted that he had been at a conference with European business leaders at the weekend, and there had been a presentation on relative inflation rates and a number of other statistics across Europe. The figures attributed to the UK was very much in line with the Euroland average and two or three countries showed a wider deviation than the UK from

Euroland as a whole. Mr Bailey noted that a number of countries such as Spain were looking at structural measures they could take, such as a liberalisation of the telecoms market, to reduce managed prices. Mr Neill asked whether a paper could be provided for Court on productivity growth and inflation trends in the UK, and their implications for the UK position on the single currency. The Governor said such an analysis would be helpful to all, because productivity growth was difficult to understand. The Bank would see what it could do. In reply to a question from Mr Morris, about the impact of the fall in the Euro for the UK export position, Mr Vickers said that the issue was very much part of the forecasting round the Bank had just been through. There were lags, but if the level of the Euro persisted the Bank would expect to see the effects coming through.

THE GOVERNORS' ENGAGEMENTS

The Governor reported that due to other commitments both Sir David Lees and Sir Colin Southgate were unable to attend the meeting in Birmingham the following week, and hence this was their last attendance at Court. The Governor said he would like to record in the minutes his deep personal appreciation and the appreciation of the Bank and the rest of Court for the tremendous contribution both had made during their terms of office. He reminded Court that Members would have an opportunity to thank them again at a dinner on 23 June. The Governor said he was very sorry to see Sir David and Sir Colin going. He thanked them in particular for the sterling work they had put in as Chairmen of the Audit and Remuneration Committee respectively.

In accordance with Schedule 1 paragraph 13 (5) and (3) of the Bank of England Act 1998 all members of the Executive withdrew and Dame Sheila Masters took the chair.

A REPORT FROM THE CHAIRMAN OF THE REMUNERATION COMMITTEE

Sir Colin Southgate introduced the following recommendations from the Remuneration Committee:-

1 That with effect from 1 July 1999 the Governor's salary be increased by the same percentage as the Government's inflation target.

2 With effect from 1 June 1999 Dr Sushil Wadwhani, on becoming a member of the Monetary Policy Committee, be offered the standard contract for external MPC members with a salary of £128,125pa, as agreed by Court last December, plus a supplement calculated as 15% of salary in lieu of membership of the pension fund.

Court APPROVED these recommendations.

In addition Sir Colin drew Court's attention to the fact that Messrs Clementi and King had lost their entitlement to Court Fees when the Bank's 1946 Charter was revoked in June last year. The Governor and the Executive Directors had had their fees consolidated into their salaries but this had been omitted for the Deputy Governors. That omission had now been rectified and payments had been backdated to last June.

Sir Colin Southgate brought one further item to Court's attention, relating to Sir Alan Budd's purdah arrangements on taking up a Directorship of Old Mutual. In response to proposals from Sir Colin, Court agreed that the proposed Directorship of Old Mutual was a conflict of interest for Sir Alan. It agreed to compensate him for a delay in taking it up. Court agreed that the purdah period would be calculated as three months up to 1 September 1999. It also agreed the compensation should be paid on the basis of Sir Alan's MPC salary plus a capped 15% non-pensionable supplement in lieu of pension. In reply to a question from Mr Allsopp, Sir Colin said that Mr Wadhwani would be full-time at the Bank.

Court rose.

19 May 1999

A COURT OF DIRECTORS AT THE BANK'S WEST MIDLANDS (BIRMINGHAM) AGENCY

WEDNESDAY 19 MAY 1999

Present:

Mr George, Governor

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Stability

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Mrs Heaton

Sir Chips Keswick

Ms McKechnie

Mr Morris

Mr Neill

Sir Neville Simms

Mr Stretton

The Minutes of the Court of 11 May, having been circulated, were approved.

MONETARY STABILITY ISSUES

Inflation Report together with the economic and monetary discussion, incorporating the monthly MPC Report to Court. (Messrs Vickers, Plenderleith, Clark and Jenkinson together with Sir Alan Budd in attendance)

Mr Vickers noted that five members of the Committee had been in favour of unchanged rates at 5¼% and four in favour of a reduction of ¼%, according to the minutes of the May meeting, released that morning.

Mr Vickers said that the theme in the Inflation Report was that: the economy was on course for growth with low and stable inflation, around the target of 2.5%; the outlook was not so much for a soft landing as for a gentle take-off, but he noted that there were many uncertainties.

The four main developments since the previous report had been that the prospects for the world economy looked a little brighter, there was a broadly based increase in business and consumer confidence, an easing of domestic inflationary pressure, but a further rise in the exchange rate. Turning to the world economy, he noted that the US had experienced yet further non-inflationary growth, while in the Euro area confidence had weakened, though interest rates had been cut in April. Japan might have stabilised, but the outlook was uncertain. In emerging markets there were some signs of recovery, and he noted that spreads had fallen.

Mr Vickers said that there had been a broadly based improvement in confidence, but the indications in manufacturing were still pointing to a decline in output. Services and construction indicators suggested positive growth, and there were signs of restored consumer confidence, for example in the housing market. Turning to domestic inflationary pressure, he said broad money growth had eased, earnings growth and wage settlements had fallen back slightly while inflation had remained close to target and inflation expectations were reasonably anchored. He noted that the exchange rate had risen further and was 4.5% higher than anticipated in February and had shown a 6% rise against the Euro. The policy response depended on the reason for the rise, which was difficult to understand. He commented that the exchange rate mattered only through its effect on prospective inflation. Mr Vickers also drew Court's attention to the labour market data released that morning, including a 17,000 fall in the claimant count for April, to a rate of 4.5%. He noted that on the face of it this was quite significant, but there were issues about seasonal adjustment, and care was needed in the interpretation. He also noted that headline earnings growth was running at 4.8% compared with 4.6% in the figures released a month earlier, though this was partly because a weak December had dropped out of the figures.

Mr Plenderleith said that the market had had a great deal of news to digest. He noted the tightening of the US policy stance, announced the previous night, speeches by the Governor and Mr King, and the figures for the labour market. It was remarkable that recent news had moved markets so little, and sterling had remained extremely firm, and had been untouched by the publication of the minutes and by the US tightening announced the previous night. The explanations might partly be because the UK economy looked as though it was moving on to a growth path and partly because of the weakness of the Euro. It was not obvious what was going to alter the outlook of sterling in the short-run.

Mr Buxton said that confidence had definitely improved a little and he detected no real inflationary pressures in the economy. He supported a further cut in interest rates. The economy was showing more growth than previously thought, but certainly not as much as the Treasury had originally forecast. Sir Neville Simms said that activity was still strong in the construction industry, but new orders had weakened. In the West Midlands, the construction industry was quite strong, because the commercial sector continued to expand in and around Birmingham, while the industrial sector was performing badly. He said he had been lobbied heavily on the extent to which the West Midlands manufacturing sector was suffering. In response to a question from Sir Neville about the impact of the war in Serbia, Mr Jenkinson said there had been discussions with the Treasury, which had indicated that the additional spending would be containable within the contingency reserves. The Bank had been looking closely at whether it could detect a knock-on effect in business and consumer sentiment, and had identified this only at the micro level among firms involved in that region. It was possible to see some effect, therefore, at the margin but it was not yet a major factor. It was also possible that there could be an effect via the exchange rate, and the Bank was monitoring this closely. Mr Buxton noted that he was a director of a Hungarian hotel group which had been expecting a sharp fall in bookings which had not yet happened, which was surprising.

Mr Neill said that the April figures for car sales were up 6.6% and retail car sales were up nearly 20%. He noted that imports were 72% of the market, and nobody was forecasting a reduction in the near term. Commenting on Rover's situation, he said that the company's market share in May, to date, was less than 3%. This compared with 7.5% last year. Suppliers to Rover would be very unhappy. He noted that the industry had had the confidence to put its full year forecast up for overall sales. The final quarter might not be so good but generally the level of confidence in the industry was rising.

In response to a question from Mr Allsopp about the difference between index-linked gilt yields in the UK and yields on US index-linked bonds, Mr Plenderleith said there was a technical factor which had to be taken into account. This was noted in chapter 1 of the Inflation Report. Pension fund requirements artificially depressed the yield on UK index-linked gilts. It was not thought that that explained the full difference. An additional possibility might be that the UK market was very much more developed over nearly 20 years than the US market, which was embryonic. It was difficult to measure the yield differences because of the distortions in the UK market. In response to a question from Mr Allsopp about why these differences were not arbitraged away, Mr Plenderleith said that some investors had tried and had had their fingers burnt.

Mr Stretton noted the difficulties of the farming industry, though he believed Scottish farmers took a realistic view, in that they accepted that the level of the exchange rate was a by-product of the Bank doing its job. There was no doubt about the level of pain being felt. Sir David Cooksey said that in a range of IT companies there was a distinct softening of demand. All of those he was involved with had a very high export content of up to 80% of the business. The further hardening of sterling was hitting margins. He also noted the troubles of Marks and Spencer, which had precipitated deflation in the price of clothing in the UK, and consumers were beginning to delay purchases. As a result, the rate at which the manufacturing side of the clothing industry was being exported was phenomenal, and he expected a drop of about 30% in UK capacity this year.

Mr Bailie noted that confidence depended on whether you were an exporter or not. However, there was beginning to be a realisation that it may not be possible to go back to the levels of sterling which had been enjoyed previously. In response to a question from Mr Bailie about what he saw as contradictory statements on the exchange rate, the Governor said that this had more to do with the way statements were reported than with what had been said. Because of the restraining impact of external factors - global demand and also the exchange rate - there was a dampening of inflation in this country. The MPC could try to compensate for this external downward pressure by pumping up domestic demand. He drew Court's attention to chart 4.6 on page 37 of the Inflation Report. At some point this external influence would erode and indeed the exchange rate effect would erode even if sterling stayed where it was. At some point the world economy would begin to stabilise and there were signs that was happening, although there were still downside risks. At that point, the MPC would have to reverse policy to restrain domestically generated inflation to accommodate the additional pressure on inflation coming from the external side. The MPC knew that it was pumping up demand at this stage and it also knew that it was going to have to restrain it some way down the tracks.

Mr Buxton noted that the troubles of agriculture were as much due to factors such as Russia buying less pig meat and sheep fleeces as to the exchange rate, and it was not going to come right quickly. A number of farmers, particularly tenants, were going to go out of business. He noted that in textiles there were other factors too, such as the minimum wage. Firms had previously been lowering wages with the use of cheap labour. Monetary policy and the exchange rate were not the drivers of these troubles. These were industries affected by other factors, which had greater impact. The Governor agreed.

Mr King asked whether Members of Court had any recent evidence of the impact of the minimum wage on labour costs. In reply, Sir Neville Simms noted that the Working Time Directive was hitting the construction industry very much more than the average of the economy as a whole, as were the various changes in self-employment rules. In six months' time, the industry might be able to separate the issues out and comment on them. Mr Bailie believed that the impact of the minimum wage and the Working Time Directive were both pretty neutral at this stage. Mr Neill believed that more would be seen of the implications of the Working Time Directive as companies faced up to what it meant. Sir Neville Simms agreed with a suggestion by the Governor that holidays rather than hours worked were the more significant factor. Sir Neville said that his industry used not to pay for all holidays and now it did. This was likely to lead to an increase of 2-3% in the wage bill. For employment agencies, the increase could be around 6% of the wage bill. Mrs Heaton noted a very similar situation in the healthcare industry.

The Governor invited a last word on the economic situation from Sir Alan Budd, who would be leaving the MPC at the end of the month. Sir Alan noted that in his speech to the CBI dinner the night before, the Chancellor had praised the Committee. In his own view, he believed that the MPC had gone extremely well for its first two years and it had been a great pleasure to be involved in it. The report to Court was a very valuable part of the process and he welcomed the way Court had carried out its duties, the contribution it had made and the probing questions it had asked. The whole system, including the role of Court and the Governor's chairmanship was working extremely well. The Governor thanked Sir Alan on behalf of the MPC and of Court for the contribution he had made in both forums. He wished him every success in his new role as Provost of Queens College, Oxford.

FINANCIAL STABILITY ISSUES

Developments in International Markets (Messrs Clark, Vickers and Plenderleith in attendance)

Mr Clark said that on the international side the story was similar to the previous month, but more so. The trend was to improvement in many of the emerging markets and this had been reinforced, including an improvement in growth prospects. It was now expected that in East Asia most, if not all, the countries concerned would register some growth in 1999. That was welcome, but there was concern that to the extent the prospect was improving it might diminish the zeal of a number of countries to carry through the structural reforms required, for example Korea. Brazil had turned round quite markedly in its fortunes, and short-term interest rates had fallen from 45% to 27%. The fiscal numbers were more or less on track with the IMF projections, and a virtuous circle looked more likely to materialise than it had before. Russia remained a problem, with debt maturities around $17bn this year against $11bn of reserves. Of the maturities, about $5bn were due to the Fund. There was a real and acute question of how Russia was going to renegotiate that debt. In China, growth was about 7% but behind that were some fairly serious imbalances and continuing problems of financial structure that had not been resolved.

He noted the three sub-groups of the Financial Stability Forum, covering hedge funds, capital flows and off-shore centres. These would be meeting around the end of the month with a view to reporting in time for the IMF and World Bank annual meetings. Mr Clark also noted that there would be a G10 Deputies meeting in early June. The private/public balance in resolving debt issues would be on its agenda.

Turning to the year 2000, Mr Clark said the Bank had been working on the preparedness of markets and institutions in London. Focus was shifting to market impacts in advance of the event. He and Mr Plenderleith had been to Washington to talk to the Fed. Next week the Bank was holding a symposium to take stock of Y2k issues across the board, and the symposium would be reporting at the end of the day to the Governor and to Mr Davies, who were chairing the final session. In the background, the Bank was looking intensively at the contingencies that might arise in the markets.

Reporting on his visit to Macau, the Governor noted that the Governor of the People's Bank had a very clear idea of the long list of things which he needed to do if China was to change the structure of its economy. These included attending to insolvency and accounting laws and the question of what to do about the banking system and State owned enterprises. The Governor also noted the responsible stance China had taken on its exchange rate, but there was an issue of how long it was sensible to maintain that posture. With the encouragement of the Governor of the People's Bank, the Bank of England would be seeing if it could form a view which might be helpful to them. He noted that in the context of the World Trade Organisation negotiations, the Chinese had been asked to move much faster than they could accommodate, and he felt the Chinese had a point. An issue was the pressure on this front from the United States, echoed from Europe.

Sir Chips Keswick noted the problems of corruption and excessive bureaucracy in a number of the countries that had been experiencing difficulties, and these problems would hold back their recoveries. He noted that in Malaysia there was a widespread view that capital controls had helped return the economy to reasonable stability, a view which was seductive, but the question was how could investment be stimulated in this environment. He believed that the risks of more difficulties in the markets were greater than some central banks assessed them.

In response to a question from Sir Neville Simms on the extent to which changes in the balance between public and private sector debt were incorporated in modelling procedures, Mr Vickers said there was clearly a substantial expansion in public investment plans. The Bank had not done micro-modelling of the split between public and private sector investment. It took account of it in the broad sense. He said it was an issue that perhaps the Bank should reflect on.

Ms McKechnie raised the issue of Y2k preparations. She said there was the issue of how companies reacted to Y2k, of fear of how they would react to Y2k and of fear about fear about Y2k. There was a very high level cynicism, and anodyne statements about events being under control were not going to get the confidence of the consumers. In a consumer perspective, the way the Government was handling the issue was not very effective. She suggested it would be helpful if there were some kind of exchange between the Bank and specialists at the Consumers' Association. Mr Clementi said that one of his main concerns, from a Bank of England perspective, was the reputational risk relating to whether there was an ample supply of notes. If consumers emptied their bank accounts to take out notes, there could be a problem. The Bank had taken steps to have very many more available this year, so there would be several hundred pounds in cash for every person. If the view were promoted, in the tabloids or perhaps at the Consumers' Association, that the Bank was not going to provide enough, then there would not be enough. He noted that he had invited Ms McKechnie to let him know who in her organisation the Bank could talk to to ascertain whether what the Bank was doing was considered to be enough. Sir David Cooksey noted that advice from the public authorities in the United States that people should keep three months medication in store had had a phenomenal effect on suppliers. Mr Buxton said he would like to see more co-ordination, probably from Government, about announcements that risk creating a sense of fear. He noted that the Financial Services Authority had created fear when it said that two of twelve big institutions in the financial industry were in line to fail. All had been tarred with the same brush, because none had been named. There were different attitudes in different official organisations which added to the fear. Someone should be in charge of the process. The Governor said that perhaps the Bank could take advice on that during its seminar. Mr Clementi noted that Mr Foot of the FSA would speak at the seminar. He also noted that Mr Foot had previously given red marks against twelve institutions and last month he had reduced the number to one red mark. It had to be reduced to zero, and if that were achieved the process as a whole would be more credible. Those companies given a red mark, even though they had not been named, had worked flat out for fear that their names would come out. He believed that the FSA had played this issue well and its actions had triggered intense efforts.

Ms McKechnie suggested that the chairmen and editors of major newspapers should be briefed on the full picture, and told their responsibilities. Some measure of pressure on the tabloids was going to be necessary. There were unlikely to be catastrophic problems, she believed, but there was likely to be a catalogue of difficulties, for example in hospitals. It was necessary to be as honest as possible.

In response to a question from Dame Sheila Masters about whether there was likely to be a surge in demand in the economy generally, Mr Vickers said that one of the responses to questions on this subject, asked by the Agents, was simply that it was too early to ask. Firms might be building stocks, but it was very unpredictable. Mr Plenderleith noted that banks were trying to discourage drawing of notes, and it would be helpful if it were possible to ensure that the press did not run unreasonable scare stories. He noted the importance of giving precise factual information, which was the basis on which the banks had gone about dealing with the problem.

Mr Clark noted that co-ordination was an explicit part of the Action 2000 brief. From next month there would be a programme of statements by Ministers aimed at building confidence. The issue was well within the sights of Action 2000. The Governor commented that another organisation, Task Force 2000, was not sensitive to such issues. Mrs Heaton said that there were a number of Y2k impacts in the Bank, including contingency plans for settlement. It would be useful to have a periodic report to Court as the date drew closer. The Governor said that the next Blue Book would be sent to Directors, and there would be a report to Court on the seminars and it would then be possible to assess whether further reports to Court would be required.

The Governor noted that his foreword to the Annual Report said that he was pleased to report that the Bank was now millennium compliant whereas the Executive Report said that the Bank was now confident that its systems "will be ready". Mr Plenderleith said he was happy to resolve that in favour of what the Governor had said, since the Executive Report had been drafted two months before. There had been further work to be done in the first quarter, at the time of drafting. This had been completed by April. He had given to Mr Footman language that reflected that the Bank's critical systems were now compliant. Mr King said that he did not believe the Agents were, as yet, compliant and a paper would be brought to Court in June on a three month programme of work which include bringing the Agents' systems to compliance. Sir Neville Simms said that last time the Audit Committee had met the situation was not that the Bank was compliant, but that it was on track to be compliant. Court had the Executives' assurance, but not the Non-Executive Directors' assurance on this issue. Dame Sheila said that Mr Plenderleith was referring to critical systems, and the Governor's judgement was that the Bank was millennium compliant. She was not sure that this should necessarily cover matters such as the one which Mr King had referred to. The Governor commented that such issues were not relevant to public confidence in the functioning of the system. If there were an attempt to be too precise it would generate a problem. He was confident in his statement that the Bank was millennium compliant. Sir Neville said that the Audit Committee would have accepted a statement from Mr Plenderleith to the effect that critical systems in operating areas were now compliant. The Governor said that unless Court strongly advised him otherwise he would leave his text the same and he hoped Court would accept Mr Plenderleith's modification to the Executive Report. Court AGREED.

MANAGEMENT OF THE BANK

Report and Accounts of the Bank for the year ended 28 February 1999. (Messrs Clark, Plenderleith, Vickers, Berkowitz and Footman in attendance)

Mr Clementi said that Court had to approve formally the signing and printing of the Report and Accounts, the signing of the Letter of Representation to PricewaterhouseCoopers, copies of which were in folders, together with an accompanying letter from PwC, and the final payment to the Treasury next October. Mr Clementi noted a number of minor changes, but said he was not aware of any changes that invalidated the statements that the Executive had made at the previous Court meeting. He also noted that Court was being asked to agree a final dividend of £37.32mn on 5 October, which was acceptable to the Treasury and would be added to the interim payment on 4 April of £32.4mn. The total of £69.7mn was rounded up in the Accounts to £70mn. This was 50% of the profit, having removed the tax charge. Referring to the Letter of Representation that he and Mr Midgley would sign to PricewaterhouseCoopers, Mr Clementi said he knew of nothing that would invalidate what had been said on this subject the previous week. Mr Footman noted a small number of minor changes to the Report, including the reflection of comments made by the Treasury, which had been reported to the last Court meeting, together with changes to the text to deal with the points made in the previous Court meeting about the usage of the words "strategy and objectives" and their relationship to the wording of the Act. The Governor asked Court whether Members wished to make any comments, and there were none. He asked Court's approval for:

1 The Report and Accounts to be signed and printed with publication on 26 May.
2 The Letter of Representation to be signed.
3 The final payment to HMT of £37.32mn payable on 5 October.

Court APPROVED the proposals.

Court was up. Sheila V Masters 16 June 1999
Peter Rodgers

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 16 JUNE 1999

Present:

Mr George, Governor

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Policy

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Bailie

Mr Buxton

Mr Hawker

Mrs Heaton

Sir Chips Keswick

Ms McKechnie

Mr Morris

Mr Neill

Mr Stretton

Mr Davies

Before Court commenced Dame Sheila Masters offered the Governor her congratulations on behalf of Court on his appointment to the Privy Council.

The Governor advised Court that we were still awaiting notification of the appointment of two new Non-Executive Directors and the reappointment to Court of Sir Neville Simms, Chris Allsopp and Howard Davies with effect from 1 June 1999. He pointed out, however, that it was perfectly acceptable for Mr Davies to attend Court today and contribute fully to discussions; he was however unable to participate in any votes or approvals sought from Court.

The Governor extended a very warm welcome to Dr Wadhwani on his appointment to the MPC and he confirmed that Mr Plenderleith had been reappointed to the MPC for a new term of three years.

The Minutes of the Court of 19 May, having been circulated, were approved.

MONETARY STABILITY ISSUES

Economic and Monetary discussion, incorporating the monthly MPC Report to Court (Mr Plenderleith, Drs Julius and Wadwhani, and Professor Buiter in attendance)

Before inviting Mr King to open the discussion, the Governor pointed out that the Minutes of the MPC meeting held earlier in the month were not due for publication until the following week. Mr King, introducing the discussion, said that the most significant number of the week was the inflation figure. RPIX was 2.1%. For the first time inflation out-turns were being seen below target. The difficulty in giving an interpretation was that the current number was only significant to the extent that it was telling something about inflationary pressures further ahead. The benign impact of lower commodity prices and the higher exchange rate, with regard to inflation, would at some point wear off, and domestically generated inflation would determine the path for retail prices.

Turning to chart 1, Mr King said growth was essentially zero in the first quarter and had declined steadily from the peak just over two years ago. On the basis of the May Inflation Report forecast, the Bank expected these rates of growth to start to pick up slowly and steadily towards the trend rate next year. There were some reasons to think that the first quarter growth was unusually weak. He noted that, in chart 2, survey evidence showed a recovery but not a full recovery, and chart 3 confirmed that the dip on the CIPS services survey below 50 was an aberration. Mr King said that the labour market was not a cause but a symptom of domestically generated inflation, and he noted that the new labour market data showed employment growing, but not as fast as it had been, unemployment down slightly on both measures, and signs that the labour market was starting to turn round, but not as fast as the Bank had thought. Comparing wage settlements with the equivalents last year, there was a fall of about 0.5%, though the public sector had picked up somewhat. Between April 1998 and April 1999, private sector earnings growth had fallen from 5% to 3.7%, largely because bonuses had dropped out of the year on year comparison. On the face of it, there was some further slowdown in domestically generated inflation pressures and there was a likelihood of a few months of undershooting the target. The difficult judgement the Monetary Policy Committee had to make was how far domestically generated inflation was slowing and how rapidly it would come back to target before the benign impact on inflation of the exchange rate wore off. The exchange rate had been higher for longer than expected.

Mr Plenderleith noted the cut in interest rate to 5% in the UK and the bias towards tightening in the United States. Both changes ought in principle to moderate the exchange rate of sterling against the dollar; and the end of major hostilities in Kosovo should help in part to reverse the weakening of the euro which had been supporting the level of sterling. He noted that there had also been better first quarter economic data in Japan, and quite a strong rally in the Yen. All these factors ought in principle to tend to lead to a decline in sterling. But as the first chart showed, none of them had had any visible effect. The markets were very much focusing on relative growth prospects, including the recovery in the UK, the prospects of a slowdown in the US, and the struggle in the euro area to achieve a reasonable performance, as well as the evidence that the Japanese improvement was being led by public expenditure rather than a private sector recovery. The result was that sterling was still a favoured currency.
Mr Plenderleith also noted that the bond markets were reacting to the prospect of higher interest rates.

Sir Chips Keswick noted that chart 4 appeared to show a sharp recovery in oil prices, but producers saw an oversupply, and the expected recovery may not in fact materialise. Mr Bailie said that wage settlements were lower than last year but there was increasing evidence that there might be a second wave of settlements. At the moment it was expected that wage increases would be half a percent less than last year. As far as optimism went, the trend was from slightly negative to more positive. He expressed surprise that there was little or no impact so far from the Millennium, and the evidence was that the effect was one of substitution. He also noted that Northern Ireland house prices were rising faster than almost anywhere in the UK. The biggest factor for exporters continued to be the exchange rate. There was an increasing acceptance that the current level was not going to go away and that companies would have to start looking at ways and means of dealing with it, including getting out of some markets altogether. He also noted the productivity argument and said that there was a catch-up which could be achieved against European counterparts that could almost negate the effect of the exchange rate. However, the biggest issue in Northern Ireland was still the political settlement, rather than the exchange rate.

Mr Morris agreed with Mr Bailie's assessment of wage costs and noted manufacturers' and exporters' concerns about the energy tax. The Chancellor had said it would be tax neutral, but the impact did not fall evenly. In response to a question from Ms McKechnie, Mr King said the Bank was looking closely at the housing market and had found that mortgage equity withdrawal was not significant at present. Dr Julius noted that following the interest rate cuts an impact would be expected on the housing market, more so than on other less interest rate sensitive sectors. It was part of the transmission mechanism for Monetary Policy. What had been seen so far was not out of line with expectations. Mr Buxton said the housing market on the lending side had been remarkably stable recently and had picked up over the previous three months. He noted, however, a significant rise in default rates on unsecured personal lending.

Mr Neill said that, in his company's experience, to get good quality management it was necessary to pay a premium and to keep them it was necessary to award increases substantially more than the inflation rate, of up to 10%. The same applied to skilled workers in some parts of the business. In general, the scope for productivity improvement was so large that pay increases could quite easily be compensated by productivity gains. He noted that in traditional industries there could be higher premia for overtime payments, for instance on Saturdays, while in the newer industries the young were happy to work Saturdays with no overtime premium because they regarded it as normal. Very substantial productivity gains were also available from tele-working and home-working. The Governor commented that these points were in line with remarks made by Alan Greenspan in relation to the United States and it was frustrating that such improvements had not been seen in aggregate performance in the UK. Turning to the car market, Mr Neill said that this time last month he had said the retail market increased 20% and the out-turn for April was an increase of 19% with the whole market up 6%, which was healthy. In the first ten days of June the market was up 12% and the retail market was up 22%. It was thought that the market would fall off in the fourth quarter, not least because of the preference buyers would have for waiting for a car registered in the Year 2000.

Mr Davies said that in the financial services labour market there had been an up-turn in the last few months, after an end to hiring in the fourth quarter of 1998. Wages were being pushed up quite sharply since about the beginning of April. He also noted that gazumping had returned to the London housing market. Mr Stretton noted a tendency in the financial services labour market towards stickiness in wage rates. Total rates of pay in services would not fall back as far as might be wished. Mr Hawker noted the importance in Wales of productivity. Wales depended heavily on inward investment, which was very mobile.

In response to a question from Dr Wadhwani about whether members of Court expected to see significant lay offs in the next 6-12 months, Mr Bailie said this depended on whether firms were exporters or not. It was possible to look at exchange rates as a margin squeeze. They were a big driver to improving productivity to narrow the gap, and if it were not narrowed there would be a fall out of jobs, and job transfers. Mr Morris said there was a risk that the discussion could under estimate the degree to which businesses were global. Companies would take orders and then decide where to produce the goods.

IT strategy for the Monetary Policy process: the short-term plan (Messrs Plenderleith and Jenkinson, together with Professor Buiter and Drs Julius and Wadhwani in attendance)

Mr King introduced the paper, which considered the IT resources provided by the Bank to Monetary Analysis. He said he had instituted a crash programme and also a review of the longer term IT needs of Monetary Analysis. There had been serious problems in the last few months with systems. The crash programme to solve that problem was broadly being paid for from the existing budget. A timetable had been set and Mr King said he had asked for fortnightly reports to Mr Jenkinson and to himself. Slippages would not be allowed, and the instruction was to do whatever was needed to make the system work, for the Agents as well. Mr King also noted that there was a longer term review of IT strategy which would involve hiring external consultants to work with MSD and MA.

Mr Jenkinson noted five elements of the short term programme: completion of a two year project to switch to a new database management system; replacing the document management system; upgrading the performance of the MA network as part of the Bankwide network upgrade; replacing the network links to the Agencies and upgrading the Agency office systems; and improving the performance of the individual PCs and network in Head Office.

The aim was to complete most of the elements of the short term programme by 1 October and the Agents by November. He was not sure when the document management work would be completed. At the same time work would proceed on improving the longer term strategic direction of IT, using consultants and building on experience outside, which would mean going outside the Bank to see what others did.

He noted that the present IT manager had decided not to renew his contract and, temporarily, a senior MSD manager would play this role. The Bank was looking for the right person to take over in the longer term.

If Court wished, he would report back in November on the results of the short term programme and progress on the longer term review.

Dame Sheila Masters said she was rather shocked by the paper. She had thought it would be a strategic review but what had been produced was a list of urgent problems to be solved. If there was a question, it was whether there were the resources available to deliver the short term programme. It should not detract from the longer term strategic look which she fully supported. Directors had wanted to see Monetary Analysis look fundamentally at how IT was used in support. She suggested that a look at other companies should include the United States, which was a couple of years ahead.

Mr Neill said he strongly supported the initiative and he hoped the Bank would stop using paper systems as soon as it could. He asked whether the Bank could provide Court with PCs so that papers could be delivered electronically. That would send an interesting signal to the Bank and the outside world and would also inspire Bank staff to learn how to produce information so that it could be read and digested on screen. No one would be able to get by without using the Internet in the very near future. The Governor commented that this was a very interesting idea. Mr Clementi said that Mr Neill had raised this issue with him and he had asked the Secretary's Department to look at it. He noted that there were technical and security issues involved.

Mr King noted that, from the autumn, analysts would be connected to the Internet, and he also noted developments on the Intranet, where new pages were being designed to include up-to-date market data and comments, and links to analysts and to the financial stability area. Mr Buxton commented that there was no point, in a project such as this, in automating what already existed. It was important to look at alternatives for the future. He also hoped that the project manager was a business person, not an IT person. When he had visited the Glasgow Agency he had been told that paper documents were required because they never knew when the IT system was going to crash. Professor Buiter said that it was important that the data management system was such that senior management and external members of the MPC should be able to use it. It should not be introduced only to make life easier for analysts. In response to a question from Mrs Heaton, Mr Plenderleith said that the Year 2000 gave an opportunity to upgrade systems in the financial markets area. But in some areas, rather than upgrade, it had proved cheaper to replace old systems and bring in next generation equipment. Mr King agreed with Professor Buiter on the importance of comparisons with external peer groups. He said that the strategic review would be completed by October. The Governor noted that a report would be made back to Court in the autumn.

Agents' Report – the Millennium Effect
(Messrs Plenderleith and Jenkinson, together with Dr Julius and Ms Hyde in attendance)

Mr King advised Court that earlier in the year, the Agents had made a presentation to members of the MPC on the effects of Y2K in their constituencies and it was considered appropriate to raise this issue in Court.

Ms Hyde presented the Agents' Report on the impact of the Millennium on investment and stocks. She said that before the MPC meeting on 30 April, the strength of investment had raised interest in the impact of the Millennium on investment spending. The survey in April was therefore designed to enable Agents to explore, with contacts, the Millennium-related investment that had already been undertaken and whether there was more investment still to be completed which was specifically related to the Millennium. The survey also included a question on stocks to see if it was possible to draw some inferences about the impact of the Millennium on output. Ms Hyde described the details of the survey by sector and said that, in summary, most companies had been investing for some time to ensure systems were Millennium compliant, but 40% of companies surveyed still had more work to do. Most investment was additional or brought forward, and there was very little displacement. Some stock increases were planned but it was too early at the time of the survey – and still too early – to quantify the extent of this.

Mr Buxton commented that the more systems dependent companies were, the more the Millennium effect was likely to displace investment. Mr Stretton noted that an even bigger project lay beyond Year 2000 for many businesses, which was EMU. The decision on when to start on that work was one of the most difficult that many businesses had to make. He also noted that in financial services it was not easy to say what other investment had been displaced by Millennium investment, as the planning system did not work in that fashion. Ms Hyde said that it was clear that the area where most displacement occurred was generally the financial sector.

Building a Constituency for Low Inflation
(Messrs Plenderleith and Jenkinson, together with Dr Julius in attendance)

Mr King said that a working party on building a constituency for low inflation had been set up as a result of a request from Court, and had been noted in the Annual Report as a priority. A key part of the Bank's work was not just to implement monetary policy but to build support for its objectives. The aim was to build a wider constituency for low inflation. This was described in the Annual Report as public awareness. He noted that in the House of Lords, the Governor had been asked what he meant by "public", and he had replied "all of the public, all of the time". Various means needed to be employed for different parts of the public constituency. The intention was to increase awareness of what the MPC was trying to do and of the importance of low inflation.

The Bank already did a good deal, including publishing the minutes and the Inflation Report, to draw attention to these issues. It distributed Bank briefing with an over-view of the Inflation Report in very large numbers each quarter, written in a relatively non-technical language. However, the Bank did not have a document it could hand out that set out the case for low inflation. The working group felt that one should be produced and distributed, not just by mail but by members of the MPC when they went out to make speeches. The working group also believed that Agents should see it as part of their responsibilities to give more of their time to explaining the benefits of price stability. This did not mean giving talks specifically on the subject. But when they gave talks, they should spend a few minutes explaining that their work was based on the need for low inflation. They could take the opportunity to distribute the proposed pamphlet. There was a question of whether it should be aimed at business alone or at the general public, or indeed at both, and an issue of whether this made a difference to the drafting.

Mr King noted that the Bank had made a major effort in the field of education over the years. Experience of consultation with schools and teachers suggested that much of the material in the past had been too technical and high-level and not geared to the curriculum, so it had not been widely used. He also said that the curriculum was changing, which was an opportunity. He drew attention to the proposal in the paper for a national monetary policy competition for schools, which had been adapted from a competition run by the Federal Reserve. It would be along the lines of the debating competition for schools which used to be called the "Observer Mace", involving sixth forms. It would be judged in rounds. Contestants would have to make a case for an interest rate decision and would be judged not on whether they got the answer right but on the quality of the case they put forward. The Bank would provide the material required to schools.

Mr King noted that the curriculum was changing in two ways that were helpful, by including more on monetary policy and by putting stress on presentational skills. The competition would be designed to promote these skills. He believed it would be welcomed by teachers. There would be more consultations, and the Times had expressed interest in principle in sponsoring the competition.

Mr King also noted a proposal to produce a virtual Bank of England on a website, which would include a large amount of material for all schools, irrespective of whether they entered the competition. It would be text book-type material for schools, distributed on the Internet. He noted that the Bank had had extensive discussions with BizEd, which had had experience of working with economics institutions, particularly the Institute for Fiscal Studies, and the Bank could hire BizEd to create the site. It was feasible to do this without diverting resources in-house.

Finally, Mr King described the proposal to start opinion polling on behalf of the Bank. The public would be asked questions to discover their views on issues such as the merits of low inflation and their awareness of the activities of the Monetary Policy Committee. Tenders had been requested, and three firms had been interviewed in depth. The working party was convinced that monitoring should be regular, and not one-off, because the public would learn as time passed, and its reactions would also depend on the recent direction of interest rates. So if polling was undertaking it should be for a minimum of five years before it was reappraised. It was suggested there should be a medium term commitment, NOP had been chosen, and it was proposed to sign a contract with the firm. A poll would take place quarterly, would be on the firm's omnibus survey and would have a sample size of 2,000, which would allow a breakdown between Scottish and English trends, but not regional trends within England. There would be flexibility to alter size easily, or to do additional one-off surveys, if it was desired to increase the sample size in a particular region.

Mr King noted that resources were an important issue, though they represented a small proportion of existing budgets. There would be a requirement for additional resources and a distinction had to be made between cash outlays and staff requirements. Implementation of the recommendations would draw on the resources of staff in Monetary Analysis, and that area of the Bank was short of resources because of the workload for the MPC. That issue must govern the timetable. There were two ways in which the Bank could move quickly: first, develop the website for the virtual Bank of England, using consultants; second, the polls could be commissioned immediately, and if they were to go ahead it was recommended that they should start in early autumn. The pamphlet, however, would require resources from Monetary Analysis, even if Secretary's Department took the lead, and he hesitated to give a precise timetable because of the resources required from Monetary Analysis . Turning to the competition, he said more substantial resources were required from Monetary Analysis. The proposal included a timetable, and if resources were available the competition could be announced this autumn and take place in 2000/01. If it did not prove possible to fund resources quickly from Monetary Analysis to produce the material and to judge the competition, it might have to be postponed. However, it was clear when that decision would have to be taken, which would be in the autumn. It was not necessary to decide now.

Mr Morris said he very much welcomed the paper and he noted that the objectives and purpose of the exercise had been discussed in Court. The first question to resolve was the definition of the constituency for the pamphlet. Should it populist, should it be Internet based? Should it be for business people, for consumers, for trade unions? He also said he was very keen and interested to see a long term project that could influence the national curriculum at A-level and GCSE level, and he was pleased at the willingness to consult teachers, and suggested the Bank should go further and look to the DFEE as well. He believed the opinion poll proposal was interesting and asked whether the Treasury had been advised of it. The Treasury Committee would be pleased because it would demonstrate that the Bank had taken note of their comments. He also said that if the Bank was addressing constituencies and interest groups it should remember that not all had English as a first language and there was a huge and growing ethnic minority. He gave his total support and believed it was a very good project.

Mr Davies said he supported all the proposals and hoped Court would agree to the competition, which he found particularly imaginative. On the school side there was a read across to the work the FSA did on the public understanding of financial issues. In that context the FSA was looking at ways of introducing financial literacy into the curriculum. For many people, low inflation was an issue for savings and investments. The newspaper money pages presented it as a problem, because of declining annuity rates and other factors. Mr Davies suggested that the FSA's consumer education people be put together with whoever was working on these projects in the Bank. Particularly in the schools area, the FSA could benefit from Bank support on the financial literacy side, and there could be a spin-off from consumer education into financial literacy. The Governor commented that he saw this as a very good idea.

Mr King drew attention to a pamphlet produced by the Reserve Bank of New Zealand on what low inflation meant for savers. The Governor said that this was not just a schools point. The savings constituency was a distinct one, which it was necessary to address.

Mr Neill said that an omnibus survey would be very cost effective. He proposed that there should also be some segmentation because it would be interesting to see the attitudes of key audiences such as journalists and MPs. They moved in different ways. It helped to support quantitative evidence with qualitative work. Commenting on the schools project, he said that after the wider share ownership task force recommended that a mechanism was needed for getting pupils more interested in share ownership, he chaired a CBI task force to see how games could be developed for schools. There was no shortage of ideas and the problem was how to implement and sustain them. He asked whether there was a wider range of partners that could join the Bank, with a common interest in seeing if something could be produced that was really enduring. Sir Chips Keswick said that the Bank should not underestimate the worries of fixed interest savers. He noted the low level of annuity rates and said he hoped that some comfort could be given on the issues pension savers were worried about. The Governor noted the significance of these issues for borrowers as well.

Ms McKechnie said the pamphlet proposal was fine, but the bigger problem was effective distribution. There were a number of organisations that produced such material but could not deliver it. Somebody should be tasked with planning the distribution of the paper version and with a plan for the distribution of the electronic version. She noted the number of links between the Bank and other websites. She also noted the importance of developments in the national curriculum, and said that it would be important to make a formal submission to the curriculum development review. There was a lot of competition to get material into the curriculum. The problem was not developing material but ensuring effective distribution in a form schools could use. Mr King said that this was very helpful and the Bank would look into her comments on distribution. The Bank had been working with two consultative groups of teachers and this work would be expanded when producing the final design. On electronic distribution, the Bank had a large number of buttons on other websites and would work to make these connections more targeted. BizEd had many contacts with schools and many direct Internet links. He noted that by the end of this year five hundred teachers would have been to Bank seminars in which Monetary Analysis was closely involved. Staff in Secretary's Department were working directly with teachers who had made clear that the Bank should not rush in, and who had emphasised the virtues of consultation. The Governor said he believed the work should go ahead as proposed by Mr King. Court was content.

FINANCIAL STABILITY ISSUES

Developments in International Markets (Messrs Plenderleith and Clark in attendance)

Mr Clark said that the main development had been the reaction to the Fed announcement of its inclination to tighten, which had had an effect on spreads. In Asia they were broadly where they had been before the announcement, but in Latin America spreads now indicated a more fragile position. That said, Brazil was in a better state than expected, with a forecast of only a small reduction in activity this year, which was very much better than expected earlier this year. Inflation was also lower than expected. He noted the difficulty of interpreting the Chinese situation. There had been a fall in retail prices of 3.5% in the latest month yet the B share component of the stock market was roaring ahead, with an increase of 100% or more in a couple of months. There might have been some official intervention or a blind eye had perhaps been turned to domestic investors in the B share market, which was designed for foreign investors.

Mr Clark also noted that there were a number of questions involving smaller countries, relating to the status of euro bonds in relation to debt rescheduling. In the past the focus had been on bank debt. The Bank of England was still working through the implications of how to handle this issue, and in particular looking at the relative position of bond and debt holders against banks as creditors. It was on the agenda of the Paris club, the G10 and the G7.

Mr Clark noted that the Bank would be publishing on Friday, the sixth edition of the Financial Stability Review which contained an expanded discussion of financial stability conditions, and it was hoped to do a greater amount of analysis of that kind than when the FSR had started.

Sir Chips Keswick, declaring an interest as a Director of Anglo American, asked whether the Government saw gold as a reserve asset or as a commodity. If it was a reserve asset, sales should not be announced in advance and instead the gold should be sold quietly. There had been a lot of upset in the market.

The Governor, commenting on gold sales, said that of course it had been recognised that the gold community would react. But he did believe that they had done themselves more harm than necessary by making such a song and dance about the sales. The significance of the announcement was that gold represented more than 40% of net reserves. This was not a sensible portfolio allocation. In market terms, it was a marginal adjustment to UK gold reserves. Of course it was perceived as having greater significance, because people asked what were the implications for the really big holders of gold. The answer was that there were absolutely no implications. If the markets had focussed on what Greenspan, Trichet and Tietmeyer had said in their statements, it would have seen that. The first five auctions would account for five percent of total gold production. It was not something that needed to generate this scale of excitement. It took place, of course, in the context of the changes in Switzerland and the IMF. But those who had gone about asking questions that had not in fact been raised by the UK decision had aggravated the problem. That was what he had told the World Gold Council when they came to see the Bank. The UK would retain 300 tonnes of gold in its reserves, and there were no implications for the attitude of other gold holders to the asset. This was not an impression that one would get from the complaints coming from the World Gold Council. The option of selling behind closed doors was not available, because as soon as that started many people would know, but they wouldn't know the pace and extent, and that would have produced greater uncertainty than announcing the sales in the way proposed. The World Gold Council had accepted that when it was put to them.

Mr Plenderleith said that if the Bank had tried to sell gold covertly it would have had to accept a discount on the price, as did other central banks that took that route, and it would not have been possible to give comfort to the market that the government was keeping nearly half. The market could have assumed that the Bank was selling the lot. The structured auction programme was the correct way to sell the gold. The London gold market was used for the selling operation, and if it could demonstrate that it could handle it sensibly, that made a very powerful powerful case for the IMF and the Swiss to use London for their sales programmes. The Governor commented that this would enhance the prospect of gold remaining an international reserve asset.

Mr Buxton, referring to Mr Clark's comments on the Paris Club negotiations on the bond market, said he hoped the club would adopt a robust attitude to bond holders. Mr Clark said that that was the general sense among other participants, though not among the bond holders, of course. Mr Plenderleith said it was a very important issue that was just beginning to be properly debated. He had chaired a panel of emerging market bond holders the day before, and none of the issuers, except possibly Hungary, had the slightest awareness of the issue yet. The debate about the implications for borrowing countries' borrowing programmes had further to go. The market was now beginning to focus on it seriously.

Executive Report (Messrs Plenderleith and Berkowitz in attendance)

Mr Clementi drew Court's attention to the recent announcement that legal aid had been withdrawn from Lord Spens in his action against the Bank. He noted that Lord Spens had been dismissed by Ansbacher in 1987, and in 1993 had begun the action against the Bank in the High Court, claiming that the Bank had caused his dismissal improperly. The Bank had at all times resisted this claim. In the last week Lord Spens had indicated that he was prepared to settle for costs plus £100,000. On 4 June the case collapsed, because the Legal Aid Board had removed his support. It was a deeply unsatisfactory process, and the judge had asked the Legal Aid Board to produce a paper on why it had withdrawn. Mr Clementi said the Bank looked forward to seeing that report. The Governor said the outcome was highly satisfactory. Mr Clementi also advised Court on the success of the recent Year 2000 symposium co-hosted with Mr Davies. This country was well advanced, and the majority of the kit had been tested and attention was turning to contingency planning. Two issues of importance to the Bank were bank notes and liquidity provision. Mr Clementi noted that the blue book would be published soon, and would include material on preparedness in the UK and the G10 and also Singapore and Hong Kong.

MANAGEMENT OF THE BANK

NMB Group plc (Messrs Plenderleith, Davison and Ms Lowther in attendance)

Mr Davison drew Court's attention to a number of charts which he had distributed. They showed total borrowing by NMB down to £114 mn. In fact it was now £104 mn. Cash flow this year was between £17-18 mn. The deficit was shown as £71.3 mn and it had in fact reduced to £69.7 mn by the end of May, excluding the £75 mn of lost capital, which brought the total cost to about £145 mn. There were about 3,000 CLC loans averaging about £15,000 each, 120 business loans averaging £250,000 each and TEFCO loans had been run down to zero. In terms of value CLC loans were £32 mn, or £27 mn after provisions, and business loans were £27 mn, or £16 mn after provisions. Mr Davison said that the business was going steadily, and there was a lot more to wring out of it. The latest year was particularly noteworthy for the settlement of a number of legal cases. In reply to a question from Mr Davies, he said that overheads were about 30% of the running margin, which would be lower if more was charged for interest by the Bank. The current charge was at Libor. Ms Lowther said the business had a loan of £104 mn, £100 mn of which was interest free, with the balance at Libor. That arrangement dated from the time of the initial injection of capital. In practice the division between interest and non-interest bearing loans was not material, because the more interest the Bank received the less it received in capital repayments, because the cash flow went to the Bank. In reply to a question from Mr Davies about whether the Bank had looked at selling NMB, Ms Lowther said there had been indications of interest in the past but they had not been seriously worth pursuing. In the last few months there had been an approach that looked to be more serious. Barings had been invited to act as financial advisers, in the first instance to value the company.

Counterfeit Notes (Messrs Plenderleith and Jarvis together with Ms Lowther and [redacted] in attendance)

Ms Lowther said counterfeit notes had been a growing problem in the 1990s and attacks had been more worrying since 1994. There was a three pronged strategy. First, there was a programme to increase public awareness of notes and their main security features; second a lot of effort was put into co-operation with and encouragement of police activity, particularly NCIS; third the Bank was looking to new security features, as and when the technology allowed. This strategy had broadly been a success since the mid 90s. A reduction in counterfeits was being seen, quite a large part of which was due to a major police success last year. She said she was fairly comfortable that the situation was contained at present, though the Bank was currently seeing an increase in colour copier counterfeits. It was continuing to pursue the strategy. The £20 note would be announced the following Tuesday, a most significant event. She would take whatever opportunity she could to emphasise the new security features of the £20 and other notes in circulation. Turning to the new note, she said the Bank would have a strong media campaign, and large quantities of leaflets as well as whatever coverage it could get on TV and radio. The campaign would be targeted, with the leaflets going to sectors that handled a lot of cash and to the vulnerable – the blind, the elderly and ethnic minorities.

[redacted]

[redacted]

Printing Works Report (Mr Jarvis in attendance)

Mr Clementi reported on a longer term examination of the future of the Printing Works. This included a possible joint venture with De La Rue in the thread market. But the Bank was close to concluding that this should not proceed because it was a rather small market and it was costly to set up a private/public joint venture. The numbers were not compelling.

Mr Clementi said that he, Mr Jarvis and Mr Bailie, who had met regularly, had all expressed concern that over the long run the status quo for the Printing Works would be difficult to maintain. Staff numbers would continue to go down as the production and usage of notes declined further. Against this background continuously improving productivity would become progressively more difficult, as the Printing Works could not behave as a private sector company and go out for fresh business. The question was whether the Printing Works would stay above critical mass.

He noted the uncertainty about entry to the Euro and the speculation over the timing. Once into EMU, it was not difficult to see how private capital could be introduced, and there could be dual sourcing of notes. However, because of the discussions over the joint venture, deliberations over the longer term future of the Printing Works had not got as far as he had wished, and he hoped for Court's agreement to continue with the investigation. He noted that he had got to know the Chief Executive of De La Rue quite well. Mr Clementi said he wished to report to Court more fully in the autumn.

Mr Jarvis drew Court's attention to the note and the Printing Work's annual report to staff, both in folders. He said two events dominated the last year. First, the cash centre and the new security entrance, which he hoped would be in operation next month. Mr Clementi would be cutting the ribbon that evening.

Second, the launch of the new £20 note and the planning of the new £10 note, which he hoped would be ready by May/June 2000. The interval was required because of the need to produce additional (£20) notes for the Year 2000.

Domestic Matters

The Governor advised Court that following the departure of Sir David Lees and Sir Colin Southgate, it was now appropriate to consider revisions to the membership of the Standing Committees of Court and the Trustees of the two pensions funds. He drew attention to a note in Court folders which highlighted the proposed changes, the most significant of which were the appointment of Sir David Cooksey as Chairman of the Remuneration Committee, the appointment of Mr Buxton as Chairman of the Audit Committee and the appointment of Sir Chips Keswick as Chairman of the Trustees of the Court Pension Scheme.

Mr Morris and Mr Stretton were invited to join the Remuneration Committee and Sir Chips Keswick would stand down. One of the new NEDs, whose names had yet to be announced by the Chancellor, would be invited to join the Audit Committee and the second of the new NEDs would be invited to join the Trustees of the Court Pension Scheme. Sir Chips would join the Trustees of the Staff Pension Fund and Mr Morris would stand down. The reason for Sir Chips joining the Trustees of the Staff Pension Fund was to provide continuity in that it was planned that the Court Pension Scheme would be subsumed within the Staff Fund early next year. In anticipation of Sir Neville Simms being reappointed to Court, Court approved the revised memberships.

Turning to Directors' commitments, the Governor reminded members that they should notify the Secretary at least seven days before committing to become a member of the board of any company or undertake any duty or assume any post or engagement which may affect their position as a Member of Court. Under the agreed arrangements for reporting Directors' commitments to Court, he pointed out that copies of each Member's commitments were to be found in folders.

The Governor noted that the Bank's new conference facility was complete and said arrangements were being made for those who wished to see it to visit the centre before the July Court meeting.

Court was up.

21 July 1999