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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 JULY 1999

Present:

Dame Sheila Masters, Chairman, Sub-Committee of Directors
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Mr Bailie
Mr Buxton
Sir David Cooksey
Mr Hawker
Mrs Heaton
Mr Neill
Mr Stretton

Mr Allsopp
Mr Davies
Sir Neville Simms

In the absence of the Governor and in accordance with Schedule 1 paragraph 13 (3) of the Bank of England Act 1998, Dame Sheila Masters chaired the Meeting of Court.

Dame Sheila Masters advised Court that as the Bank was still awaiting notification of the appointment of two new Non-Executive Directors and the reappointment to Court of Sir Neville Simms, Mr Allsopp and Mr Davies with effect from 1 June 1999, it was perfectly acceptable for Sir Neville Simms and Messrs Allsopp and Davies to contribute fully to discussions but they were unable to participate in any votes or approvals sought from Court.

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

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MONETARY STABILITY ISSUES

Economic and Monetary discussion, incorporating the monthly MPC Report to Court (Messrs Plenderleith and Vickers together with Drs Julius and Wadhwani, and Professor Buiter in attendance)

Before inviting Mr Vickers to open the discussion, Dame Sheila Masters pointed out that the Minutes of the MPC meeting held in June, which were published after the June Court meeting, were available for discussion today, together with the minutes of the MPC meeting held in July, which had been published that morning.

Mr Vickers, introducing the discussion, noted that the minutes of the July meeting of the Monetary Policy Committee showed a unanimous vote in favour of an unchanged interest rate of 5%. He noted that, in general terms, there was good news, both of stronger activity and weaker prices. Internationally, the FOMC had raised rates 0.25% points to 5% in June and reverted to a neutral bias. The West German Ifo index of business sentiment rose during the month, by more than market expectations. In Japan the Nikkei and the Yen had been quite firm over the month. Domestically, on the real side, first quarter GDP was unchanged at 0% growth, but household consumption and investment were revised up. Second quarter indicators suggested growth was strengthening in manufacturing and services, and the National Institute of Economic and Social Research expected growth of 0.4% to be shown in data to be released the next week. Mr Vickers noted May data pointing to some strengthening of the manufacturing sector, and he drew Court's attention to the CIPS manufacturing survey, which showed a faster increase in June than in May, and to the June CBI survey, which showed a small fall in the balances on orders and output expectations. He also noted the BCC survey and the CIPS services survey as well as the CIPS construction survey.

He said the housing market was interesting, with the Halifax and Nationwide indices fairly close, at about 7% year-on-year growth. House prices were increasing, but not to the dramatically high level of the late 1980s. Mortgage approvals were high and housing turnover was rising. Turning to retail sales, Mr Vickers noted that the rate of growth had picked up since the start of the year, in line with surveys, although the feedback from the Bank's Agents was less strong than from some other sources. Mr Vickers also drew Court's attention to the labour market data, including the earnings figures which showed that public sector growth had

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now crept above the private sector, a pick-up partly reflecting an unwinding effect from some public sector settlements that were previously staged. He noted that bonuses had grown very strongly in May 1998, but it was not possible to make year-on-year comparisons of the bonus effect for May 1999, because of the change in the form sent to firms. Turning to prices, Mr Vickers said that the RPI data was much as expected, and it was another month of under-shooting. Producer prices had been subdued, though input prices picked up a little because of higher oil prices.

Turning to the markets, Mr Vickers drew Court's attention to the charts, but noted a very recent rise in the Euro. Against the dollar, there had been talk of parity, but it had shown a recent recovery. Mr Vickers also noted the intervention which had taken place in the Yen. Turning to the stockmarkets, he said that the Dow Jones and the FTSE indices were overall fairly flat but there had been a significant increase in the Nikkei index.

Sir Neville Simms said the picture in the construction industry had been the same for several months. There had been a slow-down as a result of a sag in the fourth and first quarters, but it was not expected to continue. There was an underlying expectation of a strengthening of public sector work, and people were reasonably confident going forward. Mr Vickers recorded his thanks for Sir Neville's monthly paper on the construction sector.

Mr Neill said that the figures for the motor industry for the first ten days of July were not very useful because the comparison was with last year, when the numbers were very low, because people had been anticipating the change of registration plates in August. The latest data showed the market was up 121% in the first ten days, and for the retail sector 134%. He noted that the outlook for the year now appeared better than it had at the beginning of the year, but there was uncertainty about the outlook for the last couple of months of 1999 because of the possibility that customers might wait for a Millennium car. In relation to the enquiry into car prices, he commented that the industry was achieving significant cost reductions, and that could be an interesting factor in judging the inflationary impact of the car industry. In response to a question from Dr Wadhwani, he said that these cost reductions were being driven by improved productivity, technology and manufacturing processes. Mr Bailie noted that some companies were continuing to export at the expense of margins, while others were showing quality and productivity gains. Confidence was improving, while skill shortages were the second biggest

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problem companies were facing. In printing and packaging, there were some indications of an increase in pulp prices, but there was a lot of resistance to that. Television advertising was buoyant and tourism was flat. Wage costs were increasing at a 0.5 percentage point lower rate than last year.

Mr Buxton said that low growth in the first part of the year was almost all to do with the foreign trade position. In the domestic business, personal unsecured lending was still rising quite fast, though less than the previous year, while mortgage business was still quite robust. He believed customers were borrowing unsecured because they had spare income as a result of the fall in the mortgage rates. Corporate confidence was up significantly, though the number of hospital cases was also rising, which was the tail from the end of last year. The real test for the economy would be what happened internationally and in foreign trade. In response to a question from Professor Buiter, Mr Buxton said that personal bad debts were rising, and giving his bank some concern. Lending standards had been tightened twice over the last year, but the bank could put up with a certain amount of increased bad debt.

Sir David Cooksey noted an increase in the demand for equity for technology based companies and there were also a significant number of people developing systems for e-commerce and for electronic trading systems. He asked whether the Bank could inform Court of the impact of new trading systems on the markets and internationally. Mr Clementi said this was a subject the Bank was looking at, and its work included the advent of electronic trading platforms. A paper could be brought to Court later in the year.

Mr Plenderleith said the development of new trading mechanisms, bypassing existing exchanges and other structures, raised interesting competition and regulatory questions. Mr Buxton said that another factor was large fund managers trading among themselves. Mr Neill recommended looking at the wider impact of e-commerce on the economy, and the implications for inflation. It could have profound implications and might affect the Chancellor's view on the inflation target, which at 2.5% was quite high. He asked whether the Bank could produce for Court a separate paper on the impact of e-commerce on the economy. Sir David Cooksey said that the business-to-business side of e-commerce allowed much working capital to be squeezed out of companies, and that was where the relative advantage would come. Mr King said this was a good topic to consider as part of the Bank's analysis of

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structural and sectoral issues and would be carried out by Mr Vickers' team. He did not wish to set a date now because of resource constraints, but a paper would be produced next year.

Earnings and Monetary Policy
(Messrs Vickers and Plenderleith, Drs Julius and Wadhwani, Professor Buiter and Mr Bond in attendance)

Mr Bond summarised his paper for Court. Drawing attention in particular to the average earnings index, he noted that the Office for National Statistics was aiming to implement further improvements to the index. The Bank had a team advising on the issue.

Sir Neville Simms noted that structural issues such as the Working Time Directive might be one-off, but they could be quite significant, and in the construction industry the Directive had increased the wage bill by 2-3% and in the case of the self-employed by 6%. He complimented Mr Bond on his paper. Mr Allsopp noted that research on the NAIRU was not just a British issue but applied almost everywhere. He also noted that hourly earnings in the UK had been low compared with Europe and he wondered what had happened to these differentials.

In response to a question from Dr Wadhwani about the extent to which the minimum wage had exerted pressure to restore differentials and the extent to which firms had pre-empted the minimum wage, Dame Sheila Masters said that she had not come across many companies that had been discussing the issue. Mr Bailie said it was not an issue in Northern Ireland. Mr Neill said he had heard of one firm in the service sector which had suffered a £1,000, 000 increase in its wage bill. Sir David Cooksey said he was Chairman of a large textile employer which had not been affected at all. However, the company had also exported two-thirds of its jobs in the last couple of years. Mr Buxton agreed with Dame Sheila that the impact was not economy wide.

Non-Policy Meetings of the MPC
(Messrs Vickers and Plenderleith, Drs Julius and Wadhwani and Professor Buiter in attendance)

Mr King drew Court's attention to the paper. He noted that a six-monthly meeting of the MPC on planning communication strategy for the following six months had taken place during the period. Members had spent some of the time ensuring that their regional visits covered all of

the regions. He noted significant progress also on the service level agreement, which had been considered at one of the special topics meetings, with the Office of National Statistics. The agreement brought both an opportunity and a responsibility. Dame Sheila Masters asked whether it was intended to communicate particular statistical issues that concerned the Bank to the ONS. Mr King said that this would be done at a meeting in the autumn. Dame Sheila said Court would be interested once the Bank got to that stage. Mr Allsopp said he agreed that this should be part of the Court review of MPC procedures.

FINANCIAL STABILITY ISSUES

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

Mr Clementi commented that the emerging markets position was better than at the height of the crisis last autumn, but over the last month or two there had been continued concerns. Spreads had risen and many emerging markets had very substantial financial needs. That nervousness was heightened by Year 2000 concerns which touched some emerging markets, fairly or unfairly.

Commenting on the Ukraine, he said the Bank's interest was not because it was thought to be a systemic problem but because it had been proved to be an important test case, and the Bank had played a small part in the negotiations. There was a growing feeling that IMF money should not be used to bail out private sector lenders. He believed Mr Buxton would be pleased to hear that the Bank was being as tough in this regard towards bondholders as towards banks. This stance was not, however, accepted by all.

Turning to Argentina, he noted sharply rising interest rates, the prospect of an election in the autumn and the fact that one of the candidates was talking about a debt moratorium. China was another country with an essentially fixed currency, slowing demand and a worsening internal position, and these were matters of concern. Officially, devaluation was off the agenda for 1999, but the Bank's analysts expected something to happen in 2000. The Bank would monitor the knock-on effects on Hong Kong.

The Bank would also monitor the Year 2000 issue relating both to commercial banks, and particularly the note issue, and to the question of liquidity, where there were discussions with other central banks.

In response to a question from Sir Neville Simms, Mr Clementi said that the Argentine issue was clearly to do with the currency, which was fixed to the dollar. Argentineans had to consider whether to float or to go further towards dollarisation. This was the debate which Argentina was having privately with the US authorities.

Mr Allsopp said that the Financial Stability Review was an extraordinarily useful publication. He noted a disjunction between the improvement in confidence in the world and the dangerous risks described by financial stability analysts, above all the dollar problem and the US balance of payments. He asked whether confidence was being undermined by some of the worries on the financial stability side.

Mr Vickers said that a number of bad things had not happened, which was why the outlook might be better. But clearly there was still a potential for all sorts of things to happen in future. There was a consistency between the two pictures. In response to a question from Sir David Cooksey on Japan, Mr Clementi said that the systemic problems in banking were past their worst and there were signs that the authorities were getting on with resolving the problem, though not fast. However, that left the issue of the insurance companies, which the authorities had not really grappled with yet. It would be some time before there could be confidence that they had done so. Mr Vickers noted that there was no strong impetus from domestic demand in Japan, though the financial markets had been stronger. There had yet to be signs of robust self-sustaining private sector growth.

Turning to the Ukraine, Mr Buxton said there were cases where it might be worth allowing a country to buy in its debt at a discount. Mr Clementi said that the Ukraine bond was sold as recently as a year ago, and at a high interest rate. The concern in the official sector was where the money would come from. It was felt that there should no longer be a supply of public money to take private creditors out of the market. Mr Buxton said that perhaps in countries such as Brazil it was nevertheless worth providing public money.

FINANCIAL MARKET OPERATIONS ISSUES

Executive Report
(Messrs Plenderleith and Vickers in attendance)

Mr Plenderleith said the first gold auction had gone well. 25 tonnes of gold were sold for more than $200,000,000, which was very close to the market price, and the auction was just over five times subscribed. The programme as a whole had been less well received, with criticism from the miners of the damaging impact on the price, and a highlighting of the implications for the South African government of weaker gold prices. The Bank had received a delegation from the South African government that morning to discuss the issue. Mr Plenderleith also noted a bizarre criticism from the euro-sceptic camp, which saw a plot in the gold sales to get Britain into monetary union. Mr Plenderleith noted that excessive reactions to the gold sale, which was not in fact a large sale, had exaggerated the downward impact on the price. It helped, however, that the auction had been a technical success. After the series of five sales, it was proposed to take stock of how to handle sales in future years.

Turning to the launch of the £20 note, Mr Plenderleith said this had been an unalloyed success and the public had so far accepted it. He noted that Court members who wished to do so could buy a low number £20 note. The press had picked up the size of Elgar's moustache on the note and the appearance of a private house next to Worcester Cathedral. But there had been no serious upset in the launch of the note. It reflected credit on the team which had planned the publicity and the launch operation.

Finally Mr Plenderleith reported that terms had been agreed for the handing over of the CMO to CREST.

MANAGEMENT OF THE BANK

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

Mr Midgley said there was a mixture of good and bad news. Expenditure was £8,000,000 less than budget in the first quarter. Some of this was good news - for example, faster progress on productivity increases, on reductions in head-counts, in costs of premises and security and in

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the costs of overhead areas. The not so good news was related to analytical staff in Monetary Analysis and Financial Stability, where a number of jobs were not being filled and a recruitment drive was underway to address this. He further noted that Banking and Market Services was examining its own processes, and a number of small IT projects had been deferred while this was proceeding. The rest of the underspending related to work in progress at the Printing Works and some windfall gains from low short interest rates.

In reply to a question from Mrs Heaton about the shortfall of 43 IT staff, Mr Midgley said that this was related to deferred projects in Banking and Market Services. If these projects had gone ahead there would not have been unfilled vacancies, because the Bank would have recruited agency staff. There was a resource problem in IT, but it was much smaller than the number suggested, and was similar to the resource problem elsewhere.

Mr Buxton said it was wrong to defer projects unless there was a very good reason, therefore it was serious that there was a shortfall of 43 staff. Mr Plenderleith said that the projects were deferred for good reasons. None were individually significant. They were planned enhancements of existing systems. Before carrying them out he and local management had felt it was right to carry out a proper review of banking system processes. He accepted that the Bank needed to maintain spending in this area. Mr Buxton said that whether that was the right policy depended on how long the review took. Sir David Cooksey said he was particularly concerned at the shortfall in Monetary Analysis numbers. Court was aware of the pressures on that area. He asked whether it was because they were not paid enough, because the right quality was not available or because the staff were not available in general. Mr Vickers said that Monetary Analysis was about 20 staff below target. It had managed to recruit reasonable numbers over the previous couple of years. It had made a very large effort, focused particularly on Masters and doctoral graduates, and also on experienced staff, for example from the London Business School. A combination of the factors mentioned by Sir David was at work. One danger was that the pressures the department was operating under made the jobs themselves less attractive. He was reasonably encouraged by the results of interviews with Masters graduates the previous week, and five or six offers had been made to good or reasonable people. But the Bank would like to see both the quality and the quantity stronger. Sir David Cooksey said that the same problem had been seen for two years and somehow the Bank had to get over the hump. Mr Vickers said there were questions of recruitment, retention, job design

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and compensation. There were also questions about job banding, which was a salary related issue, where changes were piecemeal rather than radical. Mr Allsopp asked whether the issue was supply or competition from other institutions.

Mr Vickers said that in terms of inflows the Bank wanted senior people from outside universities as well. There had been publicity about the university economics market, and the Bank had done quite well in this area. Turning to the outflows, he noted that two or three staff had left for the academic world, but the Bank had competitors in the City who paid twice as much as it did. There were also structural changes in the Bank, with increases in analytical staff in Financial Stability and the markets area. There was a net export of monetary analysis staff to these other areas. Noting a seasonal pattern, Mr Vickers said that in the autumn Monetary Analysis should be up to strength but it was then likely to fall away.

Mr King said that two years after independence, the response of the Bank to the re-allocation of priorities was not as fast or as flexible as it might have been. The previous structure had been aimed at encouraging people to work in banking supervision. The Bank had not yet responded to the change of responsibilities in the same way. That response should not just be through outside recruitment. Masters, students or new graduates helped increase the numbers, but at a cost in both quality and in the absorption of valuable people inside the Bank to oversee their work.

Mr Clementi said there was a shortage of able analysts across the Bank, including the more analytical parts of the markets area. Dame Sheila Masters asked whether Court should look at this in the context of personnel policies over all. Mr Clementi agreed, and said that the next item on the agenda, the benefits review, was one response. The Bank would be looking very carefully in the autumn at the grading structure and at particular salaries related to it, to make it easier for analysts to move up the grading ladder. Dame Sheila said that the issue of whether shortages were affecting performance could be looked at in the context of how the Bank was achieving its objectives at the half year review. Mr Clementi said the Bank had made some progress but needed to make a lot more over a similar period looking forward.

In reply to a question from Sir David Cooksey, Mr Clementi said that the Bank had a secondment programme, inward as well as outward, but was in fact a net lender of staff. He

noted that there were similar shortages of staff both at the Financial Services Authority and at the Treasury, and it was a supply issue as well as a demand issue. Mr Vickers noted that the Bank had a significant number of people on short-term contracts.

In reply to a question from Mrs Heaton, Mr Clementi said that he did not believe that the paybill was a serious constraint in terms of analytical resources. If the Bank had a credible case, supported by Court, it could go to the Treasury for an increase in the paybill, which he believed would be accepted. He believed that any constraints should arise from Court looking carefully at how it balanced conflicting demands.

Sir Neville Simms, commenting on schedule C1 of Mr Midgley's note, said that capital expenditure was running significantly behind at the end of the first quarter but the outturn would be an overspend. He also noted that on a tour of the Conference Centre that morning, he had discovered that there were two projects requiring additional expenditure, the first on equipment to link the centre to television broadcasters and the second on video conferencing facilities. He asked whether there was room in the budget, or whether the projects would be budget capped. They should be added if they were required.

Mr Midgley commented that there had been continuously changing requirements for the Conference Centre, and that was still going on. His concern was that when that happened, the result was inflated costs. It was necessary to pin down such requirements better.

Turning to Sir Neville's first point, on the timing of expenditure, Mr Midgley said that the under-spend at the end of the first quarter represented a change in timing of a month to six weeks between one quarter and another, and that carried on through the year. The Bank had not liked the tenders, and had delayed. If it had not done so, the amounts would have been larger. The payments had been released slightly later. In response to the question from Sir Neville about whether there would be an overspend by the end of the year, Mr Midgley said there probably would be, because many of the projects concerned were slightly over, on the basis of the tenders the Bank had received. In the Head Office refurbishment project, the Bank had, early on, found the volume of work in the City as a whole had pushed up prices, and it had tried to delay tenders to ride across the hump. The latest tenders were coming down below the

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original budgets, but there was probably going to be an additional cost to the project as a whole because of that initial, more expensive, phase.

Sir Neville, returning to the Conference Centre issue, said he understood the problems, but both proposals sounded eminently sensible, and would make a very good facility into an excellent one. Mr Clementi said he was concerned at some of the changes to the original specification of the Conference Centre, and he was not happy with the way some authorisations went through without proper costing. He wished to be absolutely sure that any further proposals were properly authorised and properly costed before the Bank went through with them.

Mr Neill said the Bank should hire a full-time technical staff member whose job would be to manage the centre properly, and understand the technology and equipment. He believed this would avoid the problem his firms had faced in cost terms when it had brought in suppliers. Another advantage of a staff specialist would be that the person would be able to act as a mentor to users of the centre. He said that a good job had been done on the Conference Centre. Mrs Heaton said that she had discussed the matter with Mr King and would support Mr Neill's proposal. She noted Mr King's view that more needed to be done to exploit what the Bank had now acquired.

Benefits Review
(Messrs Plenderleith, Vickers and Footman in attendance)

Mr Clementi, introducing the review, noted that after a consultants' report last year there had been a preliminary presentation to Court earlier in 1999 and the Bank was now close to finalising its plans. It hoped for the agreement of Court. The consultants had said that the Bank workforce was the most conservative they had ever met. Staff had little idea of the value of their benefits and the Bank made no real effort to link benefits to salary rather than to personal circumstances. The Bank should modernise the package in a way that made it more attractive to bright, young recruits than to people who had been in the Bank a long time, some of whom could now not afford to leave. There had been a careful look at amending or eliminating some of the benefits. In the past, his predecessors had made changes for new recruits but existing arrangements had been left unchanged. The result, for example, was that there were now five or six housing schemes.

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Mr Footman outlined his paper. In particular, he highlighted the end of all mortgage subsidy schemes, the proposed buyout of staff on 2.5% mortgages, the possibility of a buyout of post retirement private health insurance and the continuation of personal loans, which were cheap to provide and good for staff.

Mr Footman also noted that staff were entitled to between 21 and 33 days paid leave and they could use flexi-leave to generate up to twelve more days giving a total of 42 or more days. Under the proposals, everyone would have 25 days as core leave. This would bring a few up but quite a lot down and the most senior staff would come down quite a lot. All would then have an option to buy up to ten days additional leave.

Mr Davies said that the FSA had introduced a similar scheme which was probably slightly more aggressive, because the core benefits had been cut further. Of 1,500 staff, only one person had wanted to generate the benefits of his previous package exactly. For everybody else, there was something in their previous packages that they did not want, so there was a net benefit to staff. He commented that many staff liked choice, and the spreadsheet proposed by Mr Footman was a step ahead of the methods used by the Financial Services Authority. He noted that housing subsidy had been bought out on a multiple of three. Of the 1,550 staff who came to the FSA only nine remained on TUPE terms and these were quirky cases. Mr Davies said he did not understand why the Bank wanted to keep personal loans at all. But that said, he believed that people would get used to the changes once they were over the hump of suspicion.

Mr Buxton said he strongly supported the principle behind the standardised and flexible package proposed. But he believed it was too influenced by the fact that the Bank was dealing with the most conservative audience the consultants had met, and by the fact that it was tackling the problem from the starting point of a complete mess. He believed the Bank was proposing a rather expensive scheme. He agreed with Mr Davies that there was no point in having subsidised loans. Most institutions were also reducing pension costs with moves to money purchase schemes and to staff contributions to pensions. He believed that in five years time the 6.5% benefits pot might be regarded as much too high, and the Bank would be contemplating how to reduce it.

Sir Neville Simms said the proposal was ingenious, and in principle he supported what the Bank was trying to do. He was concerned, however, at what he believed was double payment for the removal of housing benefits. He understood the reason but commented that the Bank was paying a considerable amount of money. He also believed it should be possible to negotiate the 6.5% down to, for example, about 5%. Turning to pensions, he agreed that most companies were investigating money purchase as the way forward. He also asked whether there was an issue of an increase in human resource costs to manage the scheme. Mr Footman however commented that the proposals would save on administration. Mr Footman agreed that under the proposals all benefits would end when leaving the Bank, apart from pensions. He confirmed that flexi-time could continue to be used but not as a holiday accrual. Sir Neville said he was disappointed with the proposal to employ an outside project manager, and he also wondered whether it would be better to try the scheme out in one location first, to iron out the problems.

Mrs Heaton said that her immediate concern as a working mother was that many staff needed their time off to look after their children. With reduced holidays some might not be able to do their jobs. It was worth looking at the implications of this, particularly for part-timers. She agreed with the view that loans should be dropped in order to get away from perks that had to be administered. Declaring an interest as a Director of BUPA, she said that at Lazards her right to take medical benefits into retirement had been taken away and she wondered whether the Bank was in fact being generous on that score. Mr Stretton said he strongly agreed with the line taken by the Bank. He noted that in healthcare people joined schemes very selectively and to allow voluntary withdrawals could produce a cost structure very different from that shown in the graph. He believed it had to be all or nothing with healthcare.

Mr Hawker said, with regard to pensions, that the Bank should not tackle existing staff but should examine whether the scheme should be open to new entrants. Mr Buxton noted that in considering healthcare provision into retirement, decisions depended on whether this was contractual. In most companies it was not and had been taken away. Companies could not sustain the cost of healthcare into retirement.

Mr Clementi said he sympathised with the view that the proposals were not sufficiently radical, but it was important to get them through. The 6.5% looked quite generous, but once valorised

it could subsequently over a period of time be shifted from benefits to salary. At the moment there was no concept among the staff of the value of benefits. He agreed that there was one element of double payment, in the form of the buyout for 2.5% mortgage holders. The Bank's first shot would probably be the FSA precedent of a multiple of three. The Bank was not proposing to take the cost of that one-off payment out of the 6.5%, and would like Court's agreement to that proposal. The Bank could afford a one-off payment in order to get from A to B. As many others in the City had done, the Bank could consider in due course moving new entrants onto a defined pension contribution scheme. It was, however, too difficult to bring this in at the same time. Turning to the project manager, he said that in a sense, that role was taken by himself and Mr Footman, working closely with Mr Matheson. But there was a requirement for one person who could give full-time attention to meetings, literature and issues such as the establishment of helplines. The Bank did not have the personnel to take on that task internally.

Turning to holidays, he believed the maximum the Bank should make available was 35 days, which was very generous relative to the City. Those with 25 days core leave would have the option to buy the other ten. Most young analysts were likely to stick at 25 days. It was very difficult to justify more than seven weeks holiday. On the question of part-timers, it was not that the proposals disadvantaged them, it was that the Bank's current arrangements were hugely generous. The fact that some staff could not afford to leave the Bank sent the wrong signals.

Turning to loans, he agreed that the Bank should look again, and it was hard to disagree with the principle put forward in the discussion. But the Bank would have to take a judgement on whether ending personal loans was one step too far. To ask staff to repay the money would be difficult. Only housing and education loans were being transferred to the Halifax.

Turning to BUPA, Mr Clementi said that he believed the benefit was contractual and the Bank had no right to remove it. Mr Footman said the legal position with existing pensioners was very difficult. In respect of current staff, to change the position would mean rewriting existing contracts. That was why some compensation seemed to be helpful. Dame Sheila Masters said the compensation should not necessarily be paid on the basis of the curve on the chart on page 17, because that would be throwing money away at the bottom end.

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Dame Sheila said that she understood Court to support the principle and the direction of the proposals but to be somewhat lukewarm in its support for some of the detail. Mr Clementi said he understood the view that some of the detail had not gone far enough. He noted that there would be a consultation period and the Bank would seek to implement this scheme in January or February 2000 for it to come into effect on 1 March or 1 April.

Court was content with the proposals.

Centre for Central Banking Studies Report
(Messrs Vickers, Allen and Ms Place in attendance)

Ms Place noted that in the last two years the CCBS had expanded its research and increased its interest in OECD central banks. In the last year more than 140 central banks had benefited from the Centre's products. It had recently negotiated funding with the UK government for services for poorer countries.

Mr Buxton said the CCBS was widely respected. He believed it could raise its income and it ought to try while recognising that it was providing a service for emerging markets.
Mrs Heaton said it was a very good report and she thanked the staff for it. But next year she would welcome a graph of the five year history of income and expenditure. She suggested that the Bank might keep the net expenditure constant over a period. Sir Neville Simms said that he was very impressed that the Bank could provide such services for the amount of money spent. The balance had been well struck. But he noted that the brochure, while good in content, was old fashioned. Ms Place said that the CCBS was planning to spend more on the brochure, recognised it was old fashioned and would revamp the style, to be like the Bank's Annual Report. Dame Sheila said that she would like to have a supply of CCBS handbooks.

Report on the Bank's Community Involvement Programme
in attendance)

Mr Clementi said that kept him informed of the work and raised major issues with him. said the aim was to be a centre of excellence with a wide programme which she developed and managed, reporting to There was a Community Affairs staff committee. The Bank supported national and local charities that

helped the disadvantaged to gain employment. She noted that the Bank had received an award from Tower Hamlets Education Business Partnership in recognition of staff volunteering in schools and said that more than 100 Bank staff had been involved in a range of outside activities, for example through a close relationship with a primary school in Whitechapel which included reading and number partners and a Bank mentor for the Headteacher. One particular programme for the future was the Runnymede Trust mentoring scheme for black pupils. The Bank would work with the Trust on a research project evaluating mentoring schemes for black pupils. The aim was to establish a research framework, analyse and write up findings, disseminate the findings across the UK so that mentoring could be used as a tool to raise the standards of African-Caribbean boys, and Bangladeshi and Pakistani boys and girls.

Dame Sheila Masters said that Court was well aware that the Bank did extremely good work in this area. Mr Neill, declaring an interest as a Director of BITC, said that he noted that the Bank had reduced the percentage of pre-tax profits devoted to charity. He strongly supported the excellent work and he hoped the Bank would do more of it. Dame Sheila said that the reduction was a result of the cost of community secondees falling. Mr Clementi said that the percentage of profits might increase because the Bank's profits might reduce. Mr Hawker said, declaring the same interest as Mr Neill, that the BITC had been developing methodologies for testing and assessing programmes and he urged the Bank to use those.

Court Pension Scheme Report

Turning to the Report from the Trustees of the Court Pension Scheme, Dame Sheila Masters pointed out that both Mr Clementi and Mr King had a potential interest in the Scheme, but she hoped that Court would agree that there was no need for them to withdraw. She also pointed out that as Sir Neville Simms and Messrs Allsopp and Davies were awaiting re-appointment to Court, they too were ineligible to vote on this item. Thus, with only seven members remaining, because Sir David Cooksey had departed, Court was inquorate. The Report focused on the Actuary's recommendations for a continued contributions holiday for the Scheme and Dame Sheila noted that it was a requirement under the Pensions Act for a contributions schedule to be put in place within twelve weeks of the Actuary's recommendations. Given that contributions at present were already at a nil rate, she told Court that on advice from the Assistant Secretary to the Bank's Pension Fund, it would meet Pensions Act requirements

simply to note the report at this stage but approve it at a later date when Court was quorate and when Sir Chips Keswick, the new Chairman of the Scheme's Trustees could present it. Mr Buxton asked whether Court could be told the percentage surplus, and Dame Sheila agreed that information on the movement and relative size of the fund should be available.

It was agreed to proceed on that basis.

Court was up.

Sheila V Masters

18. August 1999

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 AUGUST 1999

Present:

Mr George, Governor

Mr King, Deputy Governor - Monetary Policy

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Mrs Heaton

Ms McKechnie

Ms O'Donovan

Sir Neville Simms

Mr Stretton

The Governor extended a warm welcome to Ms O'Donovan on her first attendance at Court and congratulated Sir Neville Simms, Mr Allsopp and Mr Davies on their reappointments to Court.

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

MONETARY STABILITY ISSUES

Inflation Report together with the economic and monetary discussion, incorporating the monthly MPC Report to Court (Drs Julius and Wadhwani in attendance)

In introducing the Minutes of the last meeting of the MPC, which had been published that morning, and the Inflation Report, which had been published the previous week, Mr King said that they revealed a greater difference in view by MPC members than in the past but that

nevertheless the Committee had agreed unanimously not to change interest rates at present. The Inflation Report aimed to answer two questions. First, what had been the news since May about activity and prices. And second what were the implications of the likely path of activity for inflation in the future. The Committee had found it easier to judge the prospects for recovery than to assess the impact on inflation. The market was also yet very uncertain about the future and Mr King referred to chart 1.9 in the Inflation Report which showed the very wide distribution of the market's implied forecast of interest rates. Mr King noted that, after two quarters of flat GDP, growth had risen to 0.5% in the second quarter, which was close to trend. Confidence had recovered steadily this year and final domestic market growth had remained strong, and well above trend. Inflation had fallen below target since May and costs had also increased more slowly than expected. Wage settlements had fallen by around half a percentage point over the last year and the strong pound had continued to subdue import prices.

Mr King drew Court's attention to the forecasts shown in fan charts 1 and 2. He reported that the Committee had found it more difficult than in the past to reach a common view on the outlook for inflation and identified a number of reasons for making different judgements. Some members preferred to assume that sterling's exchange rate remained unchanged while others preferred to assume that it fell on account of interest rate differentials. Some believed that greater competition would further squeeze profit margins. Although all Committee members believed there had been significant changes in labour market behaviour over a number of years, not all agreed on its quantitative implications for future earnings growth. Mr King noted that the evidence from the money figures was contradictory with narrow money growing strongly but the growth in broad money was easing. Evidence from the housing market was also contradictory with the Halifax index now showing strong price increases while the Nationwide was flat, reversing the pattern of recent years.

Despite these differences of analysis, Mr King stressed that differences in individual member's forecasts were relatively small. Overall, the immediate outlook was encouraging as it indicated growth with low inflation. The problem was to know how far inflation would fall, and when and how quickly it would pick up again. In the circumstances, the Committee would monitor especially carefully all cost and price developments in the months ahead.

Mr Buxton said that the perspective of the corporate sector remained one of increasingly strong domestic demand offset by a poor external sector on account of the high value of the pound, in particular against the euro. But overall the corporate sector now had a more positive than negative stance. Profits remained under pressure so companies would have to pay close attention to costs. He noted that personal lending continued to rise and feared that this could lead to an increase in bad debts as the ratio of debt to disposable income increased, reducing individuals' ability to service loans. He also noted that UK companies were increasingly following the American practice of testing the edge of their creditworthiness through increased borrowing.

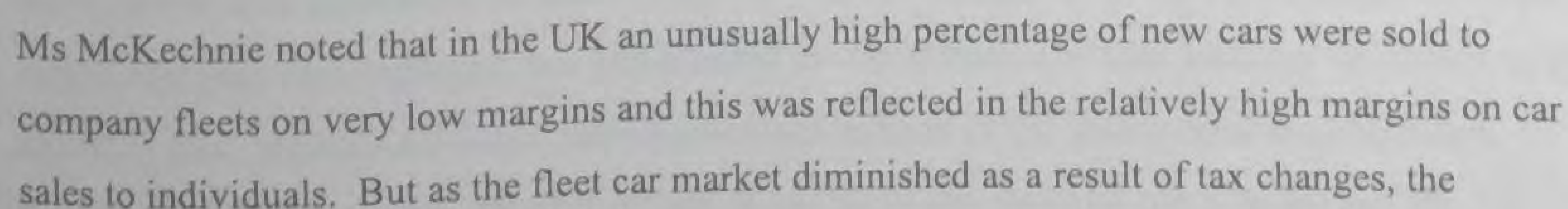
Mr Allsopp noted that the profile of the recovery in the GDP forecast closely reflected the view being offered by the Agents in recent months. The centre of the interest rate forecast looked benign but there were considerable risks including those of the uncertainty over the prospective rise and subsequent fall of US interest rates. It was paradoxical that although global optimism was increasing there was at the same time increased nervousness over the financial sector.

Ms McKechnie reported that, although progress was being made on increasing competitiveness, it was easier to change statutes and procedures than it was to change the culture in the market place. She thought the effect of changes in competitiveness would be felt mostly more than two years in the future. If greater competition reduced car prices it could have a large impact on the family budget and there would be a smaller beneficial effect as a result of reducing energy prices. Great uncertainty remained around the impact on Internet trading but at present this was not for high ticket items so its overall impact on prices might be small. Mr Stretton noted that chart 2 did not reflect the full range of views amongst MPC members and wondered why this approach had been used. Mr King explained that the chart illustrated the uncertainties around the central projection. A question was whether individual MPC members would draw their own fan charts. The Committee had agreed to continue publishing just one chart reflecting their best collective judgement of the prospect for inflation and feared that publishing more than one chart would be confusing. Accordingly, as in previous reports, the difference in their views were reflected in the text rather than in the charts. The press had reported these differences maturely and had seen it as natural that Committee members would hold a variety of views. Dr Julius said that although presentationally the Committee wished to minimise the number of fan charts, for accountability members needed to be able to give individual views

and specify what judgements would result for them. Mr Allsopp said that he had always expected MPC members to hold a variety of views and was pleased with the way it had worked in practice. Of course there were huge amounts of uncertainty which were difficult to quantify and chart 2 was a useful way of illustrating uncertainties. The Governor said that in the light of these uncertainties the Committee had decided unanimously to leave interest rates unchanged. He referred to table 6.B which quantified the effects on the inflation forecast of the different assumptions made by Committee members.

Ms O'Donovan thought that greater corporate confidence now was a reaction to the pessimism of the last two years. Companies were looking to the US market to boost their profits as the UK remained flat despite efforts by companies to make themselves more efficient. It was difficult for them to beat the effect of the strong pound – at rates below DM2.90 companies had the chance to control costs and promote efficiencies but above that rate companies increasingly moved production abroad. But it was a very big matter to decide to relocate and it would be based on how long companies expected a strong pound to prevail. Sir Neville Simms said that, at last, optimism in the construction sector was being reflected in higher orders. Industry forecasts had been upgraded for each of the next three years but he was concerned that higher cost pressures were emerging, partly reflecting changes in working practices. In the West Midlands his perspective was that the housing, leisure and commercial sectors all looked strong and even manufacturing looked more comfortable.

Mr Bailie said that the housing sector in Northern Ireland had seen a lot of demand from the Republic in the first quarter financed by low euro interest rates. However, this had cooled in the second quarter, perhaps reflecting the less confident political outlook. Turning to the economy in general, he feared that the recovery in confidence was fragile and that an increase in interest rates could have a disproportionate effect and could be very damaging. He thought that the reason the labour market remained benign despite the fall in unemployment was that companies still found that they could not pass on higher costs and so they were using labour more efficiently.



Ms McKechnie noted that in the UK an unusually high percentage of new cars were sold to company fleets on very low margins and this was reflected in the relatively high margins on car sales to individuals. But as the fleet car market diminished as a result of tax changes, the

resulting rise in the number of cars sold to individuals would increase car makers' profits. It was not a forgone conclusion that EU regulations would change and lead to greater price competition in the UK retail car market but car manufacturers were certainly trying to set up new distribution mechanisms. There was a fundamental problem throughout Europe of excess car production. Mr Buxton agreed there was overproduction leading to very low prices in the fleet market. More generally, he felt that the economy was patchy with sectors affected by the strong pound or the depressed state over agriculture continuing to do poorly. In these circumstances he did not think an increase in interest rates was wise.

FINANCIAL STABILITY ISSUES

Developments in international markets
(Mr Clark in attendance)

The Governor welcomed Mr Clark who, in the absence of Mr Vickers, presented the issues concerning both the monetary and financial stability areas. He reported that the Bank had received the first draft of the latest IMF world economic forecast and this showed a stronger growth than had previously been expected. Even at the low point of the cycle, global growth would not have fallen below 2½%pa which meant that, despite the financial uncertainties of last autumn, the low point of growth was still higher than for any cycle over the last 30 years. The IMF saw the US economy stronger both this year and next than previously expected and also a better picture for Japan this year. However, the European economy now looked a shade weaker. Emerging market economies were now projected to recover a bit more this year and a bit less next year than before, with growth rates in East Asia of around 5% in both. The main risks were whether or not the US would achieve a soft landing, including the question of whether or not the Dow might suffer a major setback; the continuing structural weaknesses in emerging market countries; and the problem of the Millennium bug. China remained a concern; Beijing had recently described the circumstances in which they might devalue their currency focusing specifically on current account performance. Argentina had suffered some nervousness after comments by one of the Presidential candidates. Russia had enjoyed stronger output this year than expected, and had secured the next tranche of IMF lending. In answer to a question from Ms McKechnie on the international aspects of the Millennium bug, Mr Clark said it was difficult to get a detailed picture of the problems faced by other countries. He

promised to circulate a matrix of 30 countries produced by Global 2000. The Governor warned that the Global 2000 figures were not entirely objective and relied heavily on countries' own views of their readiness.

Ms O'Donovan was surprised at how strong demand was for her company's products when overall US demand looked flatter. She asked if the IMF believed the prospect of a soft landing in the US had improved. Mr Clark said it was more that the longer that the US enjoyed steady growth and low inflation, the more people believed this was sustainable; that was not quite the same as saying the probability of a hard landing had diminished. It was hard to see the US continuing on its present course without inflationary pressures building up, so there was still a question about how smoothly the Americans would manage to slow their economy.

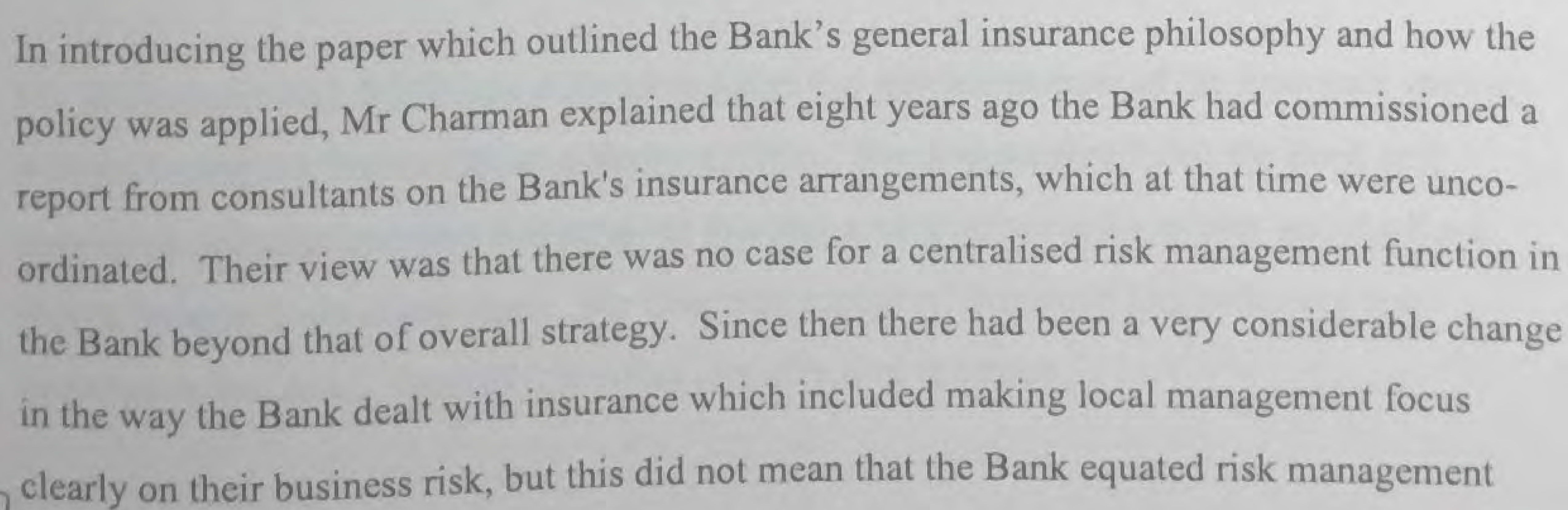
EXECUTIVE REPORT

Gold Sales

The Governor drew Court's attention to the paper on gold sales and the advice given by the Bank. This was a sensitive and topical issue and he thought Court Members should be aware of the advice the Bank had given the Treasury.

MANAGEMENT OF THE BANK

Bank-wide Insurance Cover and Uninsured Risks (Messrs Midgley and Charman in attendance)



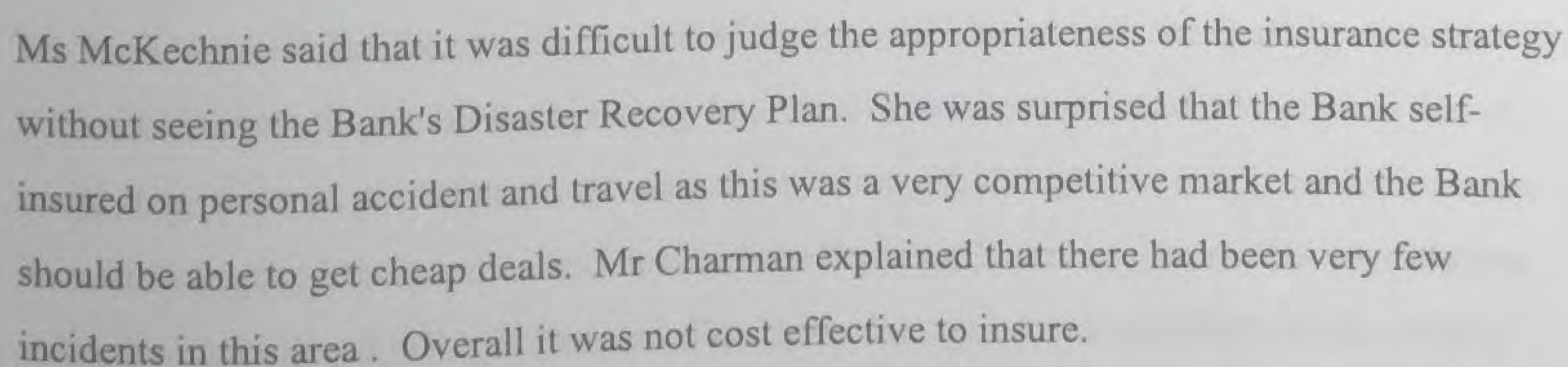
In introducing the paper which outlined the Bank's general insurance philosophy and how the policy was applied, Mr Charman explained that eight years ago the Bank had commissioned a report from consultants on the Bank's insurance arrangements, which at that time were unco-ordinated. Their view was that there was no case for a centralised risk management function in the Bank beyond that of overall strategy. Since then there had been a very considerable change in the way the Bank dealt with insurance which included making local management focus clearly on their business risk, but this did not mean that the Bank equated risk management

with the automatic purchase of insurance. Indeed, lack of insurance protection often forced management to look more closely at loss-prevention measures.

The level of the Bank's insurance cover had been reviewed and the small insurance policies, which had grown in number in the absence of a centralised strategy, had been cancelled. In general, insurance cover at catastrophe level had been increased as had insurance excesses where it was cost-effective to do so. In 1995 the Bank had switched its insurance brokers from Sedgwicks to Willis Corroon with a significant reduction in broker costs.

Mr Charman drew Court's attention to two current issues. First, the construction risks arising from the Head Office Refurbishment Project had been covered as a one-off matter with a reduced insurance excess for the duration of the project. Second, work by London Underground on Northern Line tunnels close to the Bank raised risks of settlement or subsidence in our buildings but we had obtained assurances from the Underground that they had suitable liability cover and that the Government would indemnify them for any liability beyond that.

Mr Buxton noted that, in a number of cases, the first £10mn of loss had been insured but nothing beyond that. Surely this was the wrong way round and the Bank should be more concerned about the larger losses which would affect its balance sheet. Perhaps the Bank should increase the excess and in turn seek to raise the ceiling on insured amounts.
Mr Midgley explained that the insurance market would not give unlimited cover and that the Bank sought to balance the risks it faced and the cost of insurance against the excesses. The Governor said that this should be looked at carefully area by area and when this had been done a further report would be made to Court.



Ms McKechnie said that it was difficult to judge the appropriateness of the insurance strategy without seeing the Bank's Disaster Recovery Plan. She was surprised that the Bank self-insured on personal accident and travel as this was a very competitive market and the Bank should be able to get cheap deals. Mr Charman explained that there had been very few incidents in this area . Overall it was not cost effective to insure.

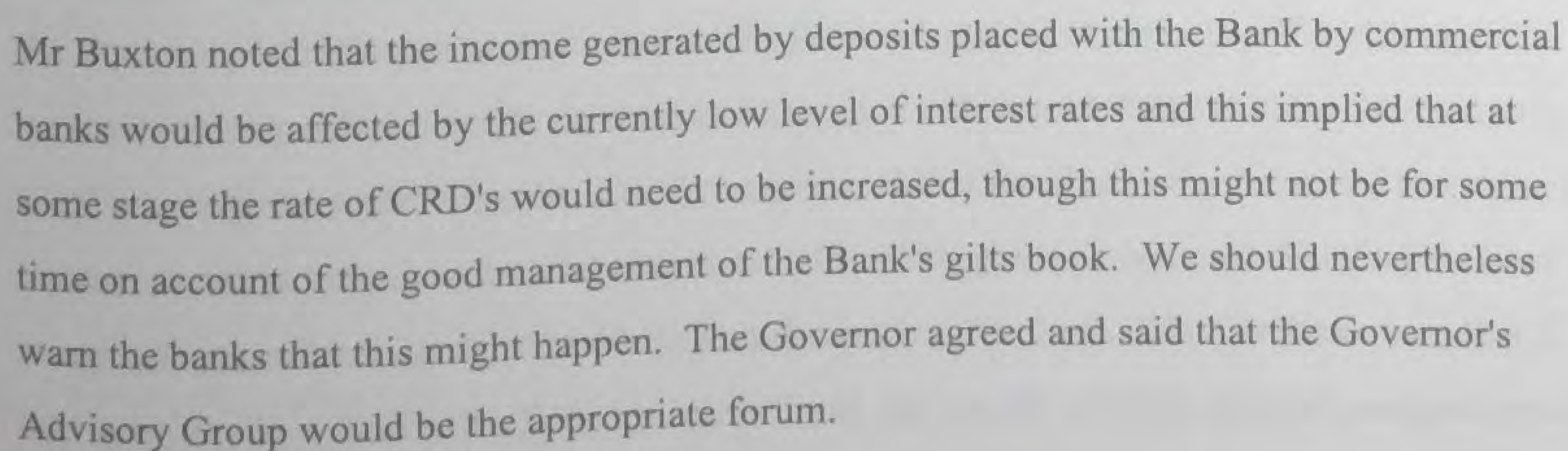
Mr Stretton said that the willingness of the market to insure large risks changed considerably from time to time and this was an area which should be kept under frequent review.
Ms O'Donovan asked if it was possible to calculate the overall cost of risk to the Bank including insurance premia, deductables, claims, and uninsured amounts. Mr Charman said in principle it was possible but it would be a substantial exercise.

Court ENDORSED the policy and noted the uninsured risks.

The Bank's Gilt Portfolio (Mr Midgley in attendance)

Turning to the paper which outlined the Bank's current strategy in relation to its gilt portfolio and, in particular, the size of the portfolio in relation to the level of cash ratio deposits and financial capital, Mr Midgley pointed out that a key judgement was what was the likely range of the Bank's operational need for cash, which was potentially quite wide. Accordingly the Bank had targeted the proportion of funds invested in gilts at 60%. Moreover, the position was likely to change once the cash management function was transferred from the Bank to the Debt Management Office. It was difficult at present to estimate its impact but, in the light of experience, we would need to reconsider the 60% target. In the meantime, the proposal was to continue to track the 60% in gilts, which implied a reinvestment of maturities and a proportion of retained profits.

In answer to Dame Sheila Masters, Mr Midgley said this would be reviewed again early next year following the transfer of cash management. The Governor suggested that it would be looked at in preparing the Annual Report, by which time the Bank would have end-year financial data and by May would have a better idea of the short term funding need.



Mr Buxton noted that the income generated by deposits placed with the Bank by commercial banks would be affected by the currently low level of interest rates and this implied that at some stage the rate of CRD's would need to be increased, though this might not be for some time on account of the good management of the Bank's gilts book. We should nevertheless warn the banks that this might happen. The Governor agreed and said that the Governor's Advisory Group would be the appropriate forum.

Court ENDORSED the policy relating to the size of the Bank's gilt portfolio.

Audit Committee

The Governor reported that Ms O'Donovan had kindly agreed to serve on the Audit Committee.

The Operation of NedCo

Dame Sheila Masters advised Court that NedCo, at its meeting on 21 July, had reviewed how it should operate in order to discharge its functions under the Bank of England Act 1998 and had confirmed that it wished to rely as far as possible on the processes established and work done for, or in, Court. NedCo had noted that, in order to review the procedures of the MPC, papers would be available on MPC procedures and information; the resources available to support the MPC; and a summary of views of those attending pre-MPC meetings. Although last year NedCo had benefited from a paper from Mr Allsopp and a meeting with senior representatives of the IMF, no special reviews were being sought this year although further proposals would be put forward for next year. NedCo had agreed to hold its meetings quarterly except that the January meeting would be brought forward to December in order to avoid the need for a NedCo meeting in Edinburgh.

Ms McKechnie drew attention to comments in the recent Treasury Committee and House of Lords Reports on the Bank and in particular the House of Lords Committee's understanding of the Non-Executive Director role in reflecting regional concerns. She thought NedCo should consider these points. Dame Sheila Masters said that Mr Rodgers was producing a summary of the Committees' criticisms and comments for discussion at the October NedCo, although if necessary this could be brought forward to September. However, there was no obligation on NedCo to respond to the Reports. The Governor said that the Bank might respond to a specific recommendation but not to general comments. Mr Allsopp was concerned that the House of Lords had misunderstood the role of the Non-Executive Directors. The Governor said that it was clear that Non-Executive Directors gave Court the benefit of their regional perspectives on the economy, but Dame Sheila Masters said that the House of Lords appeared to want

Non-Executive Directors to have an advocacy role in this regard and the Bank therefore might need to clarify the Non Executive Directors' role. Ms McKechnie said that the subtext in the Parliamentarians' view was that they wanted the Bank to take more notice of sterling's impact on industry, although the Governor noted that this was not a task which the Bank had been given by the Government. Mrs Heaton said it was important that the Non-Executive Directors should discuss any response and it was agreed that such a response would need to be co-ordinated with any response by the MPC.

Court APPROVED NedCo's method of operation as proposed.

Resources for Monetary Policy Committee Members

The Governor referred to the discussion at the Court's informal dinner and hoped to come back to the question of support for the external MPC members at Court in September. This was likely to be on the lines of providing each external MPC member with an economic analyst recruited on contract specifically for that purpose. Monetary Analysis would then be ring-fenced from MPC members, although MA might provide dedicated resources for specific agreed tasks. In the meantime, the external MPC members would be provided with an analyst and had been interviewing possible research assistants. Sir David Cooksey wondered if the new resources would necessarily be located in the Bank - would it not be more convenient to fund a post at the LSE for Professor Goodhart? The Governor said that this could be discussed but it might be more practical to house all the analysts together with the MPC members in the Bank.

The Governor said that he had thought further about the role of part time and full time MPC members and would discuss this with the Chancellor before another appointment was made to the Committee. The posts were in fact part time and should be recognised as such.

Sealing Committee Authorisations for inspection

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.

Sheila V Martin
15 September 1999

Peter Rodgers
15 September 1999

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 SEPTEMBER 1999

Present:

Mr George, Governor

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Bailie

Sir David Cooksey

Sir Ian Gibson

Mr Hawker

Mrs Heaton

Sir Chips Keswick

Ms McKechnie

Mr Neill

Sir Neville Simms

Mr Stretton

The Governor extended a warm welcome to Sir Ian Gibson on his first attendance at Court.

The Minutes of the Court of 18 August, having been circulated were approved.

MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court and the August QB report on international economic developments
(Messrs Vickers, Plenderleith and Bailey together with Professor Buiter and Dr Julius in attendance)

Before inviting Mr Vickers 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 Vickers, introducing the discussion, read out the statement made after the previous week's MPC meeting, when interest rates were raised by 0.25% to 5.25%. He noted that the Fed had increased the

target federal funds rate by 0.25% to 5.25% at its meeting on 24 August. Oil prices had been rising strongly. In the UK, growth had been 0.5% in the second quarter but the composition had been revised markedly. Private consumption growth was stronger than projected while investment was weaker, and stockbuilding made a larger negative contribution to growth than anticipated. Meanwhile, net exports were stronger, and final domestic demand excluding stocks was quite strong. He drew Court's attention to the fact that retail sales figures were to be published the following day, and said that the MPC was asking Agents to probe their contacts with questions on retail activity. Headline earnings growth had edged back up to around 4.5%. Producer input prices had been rising recently but output prices remained pretty flat. Consumer prices in August, published the previous day, showed RPIX had fallen to 2.1% and the RPI at 1.1% was the lowest since 1963. Clothing and footwear were weaker than expected. Food prices were also weak.

Commenting on the markets, Mr Plenderleith said the underlying picture internationally was of a stronger Yen, a somewhat weaker Dollar and a Euro that was struggling to hold its own. It was not clear what were the driving factors. They could include the view that the Japanese economy was beginning to struggle off the bottom, steps by the Fed to restrain growth in the United States, a short run repatriation of funds to Japan as firms cleared their balance sheets for the end of the accounting period, or portfolio shifts into the Yen, despite intervention by the Bank of Japan. Sterling was for the moment on the sidelines. Turning to forward interest rate expectations, he noted that the previous week's interest rate rise had shifted short-horizon expectations up by about 25 basis points, as the timing of the upturn expected by the market had been brought forward, but the peak the markets expected 18 months ahead had not changed.

Sir Neville Simms reported that there was no change in the construction industry situation since his last report. Mr Neill said that he had previously noted that the car industry would be confusing because of the change in the registration plates, and this was the case. He expected September would give a reasonable clue. By the end of that month he expected the market to be at a similar level to last year, perhaps 0.5% down. This would be quite a lot better than the industry had been expecting at the beginning of the year. Production for the home market was down 25% but for exports was up 14%. This gave a false signal on the impact of sterling because it reflected strong new models. Imports were continuing to achieve new record highs. Turning to fourth quarter prospects, he said it was still uncertain whether buyers would hold off for a Millennium car. Sir Ian Gibson said there had been a growth of motor industry exports from the UK following on from particular new models, but there was no overall trend for the industry. The level of vehicle imports had reached the point where the industry had to be seriously concerned. Three out of four cars sold were imported.

Suppliers were being asked to price in Euro and were finding that increasingly difficult. The components sector, which was bigger in employment and turnover than assemblers, was suffering hard times and was likely to be uncomfortable for a long period. Sourcing decisions were effectively committed for five years. He detected a degree of concern running through the whole component sector. There was no easy answer.

Mr Stretton said it was surprising how strong investment by pension funds had been during the year. He believed earnings differentials were spreading. People with existing savings may have the ability to save more, but those at the bottom end were not getting increases to enable them to save. Behaviour was influenced not by the average wage increase but by existing affluence levels.
Mr Bailie said he agreed with Sir Neville that conditions were steady but he commented that people were mostly caught by surprise by the interest rate increase. There was a view that UK interest rates at 5% had been at the bottom, and a perception that 7.5% was the upper limit. That range would give some confidence in planning. He noted the difficulty of ever getting to the Euro interest rate of 2.5%. There was evidence that some companies were more prepared to borrow in other currencies. This meant that they were probably accepting that the exchange rate would remain for the next year at about current levels, and companies were therefore prepared to borrow at the cheaper euro interest rate.

Sir David Cooksey said that in the garments and footwear industry the proportion of disposable income spent by customers had fallen from 9 to 6% in the last 7 years. Part of that was deflation in the clothing industry. There had been a fall of 15% in prices in the year up to mid 1999 and the industry was extremely distressed. Manufacturing was being pushed to a great extent overseas. He also noted an extraordinary number of business proposals being made for internet and e-commerce venture capital. His companies were getting 15 propositions a day. Some were funded but it was an area that would see a huge number of casualties in the next few years because they could not all be winners. In response to a question from the Governor, Sir David said that manufacture of clothing and footwear spread initially to Morocco, Turkey and some other countries but today 20-30% of suits sold in the UK came from Russia and lighter items came from countries such as Indonesia, the Philippines and China.

Mrs Heaton noted that a trickle of people were leaving investment banking to set up their own businesses as entrepreneurship became more significant. Sir Chips Keswick said that the house reporting season was over, and the trend of prices of new houses was upwards, though the number of new houses being built was static. He noted that market had cut the share prices of quoted builders

by 20% in the previous fortnight. Investors were beginning to be frightened that the builders would be caught if there was a turn down. Turning to the resources industry, he said consumers in South East Asia appeared to have woken up, as demand for basic materials was increasing. Mr Hawker said there had been not much change in Wales but he noted that agriculture was having a very bad time indeed. He also drew Court's attention to the substantial price cuts forced on the water and electricity utilities by the regulators from 1 April 2000.

Ms McKechnie said that her Association was trying to understand consumer behaviour, rather than what consumers said they were going to do. There were clearly some significant shifts that were structural and longer term. The figures the Consumers Association had for the number of customers going on line did not match the numbers shopping on line so confidence in electronic shopping was still missing. But if there were more accreditation schemes to give security to internet payments there might be a very fast shift.

In response to a question from Dr Julius, Sir David Cooksey said fabric supplies had moved from Europe and the US to the Far East. India had more looms installed in five years than Europe had seen since the First World War. There was an excess of supply, cheap labour, good quality fabrics and the latter were available in the same part of the world as the manufacturers of clothing and footwear. There was no reason not to buy from these sources if their design and quality standards were right. Returning to e-commerce, he said the number of transactions was less than half per cent of all transactions in the UK but in the US it exceeded 6%.

Mr Vickers, in answer to Mr Neill, said that the Bank had tried to aim off registration plate distortions in its forecasts, but the point made about new models was interesting. He also found Mr Stretton's point about earnings dispersal interesting and this was something for the Bank to track. There might be growth in non-traditional forms of remuneration, he suggested. On e-commerce, the Bank was watching what happened in the US, as a good leading indicator, but whether the UK would follow and on what time scale he did not know. Noting the point about utility prices, he said the Bank had made allowances for the water price review in the Inflation Report. Turning to textiles, he said that one aspect of the previous day's retail prices data was that the wedge between the inflation rate of services compared with goods was growing even larger, and was now about 3%.

Turning to the international economic situation, Mr Bailey said that from the perspective of a year ago the outlook for the world economy now was probably better than the Bank could have dared to hope. The latest IMF forecast, to be published the following week, showed world output growing by

3% this year and 3.5% next, a significant revision upwards for this year from the spring forecast. The IMF forecast was very much in line with the MPC's world forecast done for the August Inflation Report. In the US, the current account deficit had risen rapidly, back to peak levels seen in the later 1980s. The labour market remained tight but inflation was muted, notwithstanding a pick-up in input prices, mainly due to the sharp rise in the oil price this year. The Fed had now taken back two of last autumn's three cuts of 0.25 % each. The commentary from the Fed had put more emphasis on the pre-emptive nature of monetary policy, reflecting the perceived need to tighten ahead of inflationary pressures emerging.

Japan had been the major and positive surprise, with two quarters of stronger than expected growth. This suggested that last year's strong fiscal stimulus and the reduction of the official interest rate effectively to zero had had a greater impact than expected. With the restructuring under way, the credibility of the financial system seemed to have improved and that may have bolstered consumer confidence, so consumption was growing, even though real labour incomes continued to fall. However, the financing of consumption from a fall in savings raised questions about the sustainability of growth, which led to calls for a further stimulus from policy (fiscal or monetary).

Turning to the Euro area, he said there were increasing signs of recovery, but it was somewhat patchy. Taken as a whole, industrial production had levelled out, business confidence had begun to turn upwards and consumer confidence remained high by historical standards. Inflation pressure remained subdued, and although the ECB had flagged the possible future need to tighten, progress towards that tightening was officially described as very slow.

Overall, stronger world growth had led to rising external imbalances. Last year the US has supplied 50% of the growth in world demand but its share of output was only around 20%. Japan was moving more into surplus and the crisis economies, especially in Asia, had undergone sharp adjustments. The general consensus was that such a position could not be sustained, but the big questions were when and how a change would come. Insofar as change could require adjustments to prices, including exchange rates, there were evident tensions. The most notable was the pressure for a weaker Dollar to adjust for the external imbalances, which had to be set against the risk that a stronger Yen risked killing off growth in Japan. A second cloud on the horizon was the risk of a disorderly adjustment of asset prices, especially in the US, which had been heightened by the strengthening perception that these imbalances were unsustainable.

The Governor noted that the mood at the Basle meeting of G10 Governors, probably one of the more pessimistic groups, was really rather hopeful, not just in terms of the world economy being a good deal better than expected but also in relation to improved prospects of an orderly adjustment of the imbalances. This view was quite striking, both among industrial country and emerging market Governors.

In response to a question from Professor Buiter, the Governor said there had been a distinct change in Japan in that the Bank of Japan had been strongly opposed to intervention a couple of months ago but in the latest intervention the Bank had taken the initiative. The difference was that this time it was a response to a very rapid currency movement after the GDP figures, and was based on concerns to keep an orderly market, rather than attempt to fix a level. On the question of monetisation, the Bank of Japan had recently left a quantity of intervention unsterilised on the grounds that 9/9/99 was a date on which markets should be amply supplied with liquidity (for fear of systems disruptions).

Agent's Report – Labour Productivity and Utilisation
(Messrs Vickers, Plenderleith, Jenkinson and Pratt together with Professor Buiter and Dr Julius in attendance)

Mr Vickers advised Court that the Agents put special survey questions to a sample of their contacts each month. Earlier in the year, the Agents had made a presentation based on such a survey to members of the MPC on 'Labour Productivity and Utilisation' and it was considered appropriate to draw this topic to Court's attention.

Mr Pratt said contacts had been asked about growth and output per employee, for the previous twelve months and the coming twelve months, and also the extent to which firms could cut their workforces while maintaining business volumes. He described the sample and said there had been a good response. Three quarters of the firms volunteered supplementary comments. Overall there was a rather buoyant picture, which was at odds with the official statistics. One possibility was that the answers on productivity were rose tinted. Mr Pratt did not believe so. A more persuasive argument was that Agent contacts were talking of different measures of productivity from the national accounts. The latter measured value added per employee whereas companies achieved a lot of their reductions in workforce by contracting out - for example catering and security - and this had driven a wedge between different perceptions of productivity.

Dame Sheila Masters said that another possible explanation was an unconscious bias in the Agents' contacts towards better managed firms. Mr Pratt agreed that there might be something in that. Mr Bailie said most companies would naturally say that they were raising productivity. Mr Neill said they should be concentrating on closing the gap with their competitors. Mr Pratt said that the type of person the Agents saw was not often in head offices. They might be managing factories or in the head office of a subsidiary. He suspected the people he talked to were looking at what they could control. They were responsible for raising the physical volume of output but they might not be responsible for all the costs, including for example contracting out. Sir David Cooksey asked whether the questions could be extended to include whether productivity in the UK was improving relative to plants overseas. Mr Bailie said it was an interesting paper that left more questions than answers and a follow up would be useful. The Governor said the Agents could do that in their on-going contacts. Mr Pratt agreed that they could certainly ask about benchmarking against competitors. The best firms did it, but the small firms he saw probably did not. Professor Buiter said that surveys were always very valuable but there was a semantic problem. Words in economics did not necessarily mean the same as in business. Labour hoarding, for example, sounded bad to businesses. Mr Pratt said Agents did not use the word "hoarding". Mr Stretton noted that in services such as call centres, productivity was difficult to measure since an improvement in service standards would appear as an apparent fall in productivity. In call centres, the level of service was hugely better but the number of units processed was probably not improved. Sir Ian Gibson said that he did not believe productivity was improving that much. People tended to think of productivity in terms of running their basic operations. Most of the people he talked to in manufacturing had increased productivity in their manufacturing operations. They ignored the cost of people sitting by screens or talking on the phone to provide a better customer service. The UK had continued to outsource significantly compared with Europe. The productivity numbers suggested that this was not adding sufficient value. He also commented that most sectors in the UK had very poor benchmarking, so normal productivity improvements were still pitifully low by international standards. To come back and look at these areas would be useful, including a look at how statistics might be restructured to give a better picture of what was happening. In conclusion, the Governor said he would encourage Mr Pratt to give a message to the Agents that it would be helpful if, in their regular contacts, they could explore some of these questions more thoroughly.

FINANCIAL STABILITY ISSUES

International Issues
(Messrs Clark, Plenderleith, Vickers and Drage in attendance)

In presenting two papers addressing international matters together with a third focusing on threats to financial stability in emerging markets and industrialised economies, Mr Clark said that in emerging markets stronger growth was expected this year with a further acceleration next year. The recovery in a number of East Asian countries was more vigorous and perhaps quicker than had been expected. A number showed GDP growth of 10% or more at an annual rate. Indonesia was an exception and in China it was difficult to know how reliable the figures were. The picture in Latin America was also stronger than the Bank and the IMF had expected; there would even so not be much growth but this compared with the further falls expected previously.

Spreads in emerging market debt were still a good deal higher than a couple of years before but they may be more sensible. They had been earlier driven down to levels that did not reflect the risk. He noted an apparent curtailment of borrowing in the third quarter compared with the early part of the year. Current account deficits were now likely to be historically rather small, and lower than would be expected in the longer term. One cloud on the horizon was the extent to which structural reform in East Asia was being progressed. Another was that Brazil suffered from a high percentage of short-term government debts, so servicing costs were very exposed to interest rates; and it had also issued foreign currency denominated debt which was vulnerable to depreciation of the Real. Brazil was still in a fairly fragile state.

Mr Clark noted that in a number of emerging markets there were concerns about the Year 2000. The Bank did not have direct evidence that lending was being curtailed, and there might be a self-denying element to it in that countries were not entering the market because they were concerned about how their Year 2000 preparedness would be regarded. He noted that a Foreign Office assessment was to be made available shortly.

Mr Drage, commenting on issues relating to the IMF and World Bank Annual Meetings, said the Fund was seeking endorsement for fast and deeper debt relief for the HIPICs. There was a question of how this would be financed, and there was now a plan to achieve a valuation of gold at market prices without selling it into the market. The issues for the meeting were whether this would be endorsed and how much it would raise.

There were a raft of further issues to be discussed on private involvement in crisis prevention and resolution but there was little concrete yet in the way of agreement. He noted the importance of the Ecuador and Pakistan cases and the implications for the involvement of the private sector. In the past, the public sector bailed out the private sector. There was a feeling that this could not go on and that the burden had to be shared. One proposal was for the IMF to set a minimum reserves floor. He expected there would be continued encouragement to the private sector to introduce collective action clauses into bond contracts, though this was for the longer term. He noted that the Governor had been pressing since the Asian crisis for countries to pay much closer attention to how they managed their liquid assets in relation to their debt. Some work was being done in the Financial Stability Forum, which Mr Clementi was attending that day, on guidance for countries on how they could improve their debt and liquidity management. A great deal of attention was being given to writing codes and standards on a variety of different subjects but a key issue was how to move from writing them to persuading people to pay attention. The key was which organisation would do the monitoring. Other issues were Year 2000 contingency planning and whether the IMF had a role to play on liquidity standards, which was attracting increasing attention.

Finally the Interim Committee, which had been meeting temporarily for the last 40 years, was likely to change its status to a permanent committee and change its name. It was now chaired by the Chancellor.

The Governor noted that when he had asked what the priorities would be the Chancellor had said there would be three - implementation, implementation and implementation. In response to a question from Dame Sheila about Barclays' withdrawal from Russia, Mr Clark said even at the time of the rouble depreciation their pure exposure was not all that great. He noted that exposure of the UK banks to Russia was less than £1bn and the direct risk was small. Russian economic output was better this year than expected but everyone was conscious of the lack of a proper framework of business in Russia and uncertainty was a critical constraint. If the show could be kept on the road until the Presidential election, Russia might then take the opportunity to address some of these concerns. Nobody was looking at expanding their exposure to Russia. In response to a question from Sir Chips Keswick about Russian flight capital, the Governor said that it was not specifically IMF money, but all forms of international finance, public and private had fetched up in various forms of capital outflow. The focus had been on where the IMF money had gone but the issue was broader. What was the sense of pumping money into Russia if it ended up in the west in the hands of people fleeing the rouble? To be fair, Russia had tried to tighten exchange controls without great success. Essentially the problem was political. Russia had to implement the controls it had in place.

Domestic Developments
(Messrs Clark, Plenderleith and Vickers in attendance)

Mr Clark said that although his recent report to Court had focussed our international financial stability issues the Financial Stability Area in fact spent most of its time on domestic questions. There would be a general review of the area's work at next month's Court. Our current preoccupation was securities settlement. Two main types of risk were involved: of counterparty failure between dealing and settlement; and of failure while the settlement process itself took place. The Bank was discussing so-called central counterparty arrangements with the Stock Exchange, CREST and the London Clearing House and delivery-versus-payment with the banks and CREST to address these two sources of risk. The Governor said that real-time delivery against payment was a vision the Bank had had for a long time.

In response to a question from Mrs Heaton, Mr Clark, referring to the Stock Exchange's longer opening hours, said there was an issue of market behaviour in the first and last half hours, when trading was thin, but this was less of a concern now. Mr Plenderleith agreed. Mr Clark noted that the role of traditional exchanges was a big issue. If investment banks decided to set up trading facilities separate from traditional exchanges, or if major fund managers had the same idea and traded directly with each other, it would have important implications - and both were entirely possible directions to take. The question for traditional exchanges was what their unique selling point would be in such an environment.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues
(Messrs Plenderleith, Vickers and Clark in attendance)

Mr Plenderleith drew Court's attention to the second gold auction on 21 September and said there was no reason to suppose that the auction would not be well covered. However, the price was unlikely to be quite as high as the previous one. The Governor drew attention to a note to Directors on the advice the Bank had given the Government, which was in folders for the attention of those who had not been in Court in August. He said it was extremely sensitive and asked Directors to leave the paper behind when they left.

Mr Plenderleith reported on market management over the Year 2000, in particular the announcement planned for 20 September on a longer-term repo facility which would give firms the option of taking liquidity through into January. The Bank's sense from contact with the markets was that firms' planning was proceeding well. He noted that he had previously reported on the extension of the range of collateral available for use by the market in the Bank's operations. This and other proposals would be set out in a statement accompanying the announcement of the longer-term repos.

Mr Plenderleith also noted that the Bank had the authorisation of Court to carry out foreign exchange swaps of up to £2bn on the Bank's balance sheet. The Bank had typically asked Court to approve any increase to £3bn at this time of year, and it would now like to request an increase again. On this occasion, given that the Bank may need to use swaps over the Year 2000 period, it would be helpful if Court would consent to the swap total occasionally going above £3bn, say to £5bn, at short notice. Any excess above £3bn would be reported to Court. Mr Plenderleith said there was no foreign exchange risk to the Bank because it was matched in foreign currency. In reply to a question from Sir David Cooksey about counterparty risk, Mr Plenderleith said it was essentially another form of secured lending. Court APPROVED the proposal.

Mr Plenderleith reported that a working party of market participants chaired by the Bank had conducted a review of the structure of money market instruments and a number of recommendations had been made, all of which the Bank fully supported. The Report would shortly be published. It was mainly technical, and included for example, proposals to de-materialise paper so that transactions became purely a book entry in CREST. It was an important part of the modernisation of the structure of the market.

Finally, Mr Plenderleith reported that the Financial Services Authority had asked the Bank if it would take the lead in helping to develop a Code of Good Practice in trading certain instruments that were outside the FSA's purview. These principally comprised foreign exchange, deposits and gold. It would be an informal, not a legal code. The Bank believed this was an excellent idea which built on the wholesale market oversight which it conducted before the FSA was established.

EXECUTIVE REPORT
(Messrs Clark, Plenderleith and Vickers in attendance)

The Governor noted that Court in October would begin with a video camera present. This was part of a project to create a virtual Bank on the website. He also noted that the October Court meeting coincided with a reception by the Bank of China to mark President Yang's visit. The Bank of China had invited a number of Court Members to attend and the Governor had agreed that Mr Davies would absent himself for part or all of Court to say a few words at the reception. It was up to Members to chose if they wished to go to the reception or not, but he hoped Court would not be too greatly disrupted by that.

Turning to the proposed meeting of Court in Edinburgh in January, the Governor said that the Bank had had confirmation from Donald Dewar that he would like to invite Court to lunch on that day and Mr Dewar would invite senior figures from business and the political community in Scotland to attend. The Governor welcomed the invitation. This would give the visit the profile the Bank needed and would provide the Governor with a platform from which he could get across messages about monetary policy. The Governor noted the helpful contribution to the discussion about the Edinburgh Court meeting which he had received from Mr Stretton.

The Governor reminded Members that Dame Sheila Masters had written to them on 7 September, inviting them to make any responses that they felt appropriate to the Treasury and House of Lords Select Committees to Peter Rodgers by 8 October. This would be in time to draw the comments together for circulation ahead of the Court meeting on 20 October. The Bank would then bring Court a proposed response to the Committee's recommendations. He hoped to show Court the MPC's proposed response, and Directors would have the opportunity to discuss the NEDs' response at NedCo.

MANAGEMENT OF THE BANK

Millennium contingency arrangements
(Messrs Clark, Plenderleith, Vickers, Footman and Trundle in attendance)

Mr Footman noted that the Bank had been compliant in all its critical business systems in May and since then it had been making sure that all the non-critical systems were compliant, and in particular preparing contingency and date change plans for the New Year weekend. People would expect the

Bank to be physically operating over the weekend, but many of the contingency plans related to events before the weekend, for example banknotes and market arrangements. Mr Footman drew Court's attention to the internal preparations for the Year 2000 being made by the Bank, and also to the external preparations described in the Blue Book. There would be a communication centre in the Bank so that it could find out what was happening in the City, and act as a link between what was happening here and elsewhere. Arrangements were being made for close and continuing contact with the Cabinet Office and other parts of the UK infrastructure. Mr Footman also noted that the total cost of additional payments to staff would be approximately £250,000. In response to a question from Ms McKechnie about a UN programme to monitor developments around the world, Mr Trundle said that a very large number of different organisations were playing a part. The Bank had tried to structure standard information routes, and would only use others if it had to. In the UK and internationally, it was employing a hub and spokes approach. There were a number of important authorities in each centre that needed to be in touch with each other. In the UK financial sector, these comprised the Bank and the FSA. Each hub would have its own responsibilities. For the Bank this comprised, in particular, the payments system. Exception information would be passed to other hubs, for example the Financial Services Authority. There was a similar regime in principle across borders. Central banks were co-ordinating through the BIS. The BIS was collecting information from regulators and central banks in 27 countries, as well as from the ECB and the Bank of England is part of this network. The UN hub was probably not a direct source of information for the Bank on the financial sector. The UN would be collecting information from national Y2K co-ordinators (eg the Cabinet Office for the UK) to provide a high level picture of key parts of the infrastructure in different countries. Mr Neill asked whether on a scale of 0-10 the Bank was confident that what it planned to do would have been achieved and also where the outcome would be on a scale from 0-10 between better than expected at one end and unexpected serious consequences at the other end of the scale. Mr Footman said that one was more likely to be sacked for over-reaching than for underpreparing. The reason for the extensive weekend cover was that despite all the testing, nothing had been trialled in a live 2000 environment so it was not possible to be totally sure. But his answer on the first point would be nine out of ten. On the second question, Mr Footman said it was impossible to provide a score because of the risk of behavioural changes or problems abroad that could not be tested for. He was less confident because he did not know enough. But for the Bank's internal preparations he was very confident. Dame Sheila Masters said that this was a subject to revisit in January.

Mr Trundle said he had a relatively high confidence that the bugs had been fixed. A similar view was taken of the main G10 countries. To try to spread that confidence among others, the Bank had

published details of a number of countries' preparations in the Blue Book in July. The issue the Bank worried about was behavioural. Bankers were very cautious sometimes. There was a significant risk of thin markets over the millennium. That could have adverse consequences without anything going wrong. There was an illustration in the Far East on 9 September 1999. There was a very small technical risk of a date problem arising. But in the Far East it was perceived to be a risk, so very little trading was done for settlement on 9/9/99 and the Bank of Japan had to provide a large amount of assistance to the domestic market. Mr Clark said that a number of major investment banks took the view that bugs were easy to fix and it was not necessary to tackle them 100% in advance. The remaining bugs would be fixed in real time.

Court Pension Scheme
(Messrs Footman and Keynes in attendance)

The Governor advised Court that there were two separate matters to be addressed. The first related to a proposal that the Court Pension Scheme and the Staff Pension Fund should be merged and the second concerned a report from the Trustees of the Court Pension Scheme. The Governor added that as he was the only Member present who had an interest in matters relating to the Court Pension Scheme, in accordance with Section 13 (5) of Schedule 1 to the Bank of England Act 1998, he proposed to withdraw and in accordance with sub-paragraph (3) of the above section, he would hand over the Chairmanship of Court to Dame Sheila Masters.

Before leaving Court, the Governor advised Members that Sir Ian Gibson had agreed to become a Trustee of the Court Pension Scheme.

Turning to the question of the proposed merger of the two Schemes, Dame Sheila Masters reminded Members that the previous Chairmen of the Audit and Remuneration Committees had suggested to Court, last December, that a merger of the two Schemes should be investigated. The paper before Court, which had been produced by the Secretary to both Schemes, outlined the arguments both for and against the merger and Dame Sheila invited Members to comment.

Sir Chips Keswick noted that a difficulty for the Court trustees when the merger proposals came to their notice was that they had a duty to protect the interests of their members, including the rights of existing pensioners. They were particularly concerned about the five widows, and prior to the merger, proposed to increase their allowances from 50 % to two thirds of their late husbands'

pension. The Governor, when presented with this proposal, said he wanted to talk to the Chairman of RemCo and to Dame Sheila Masters as Chairman of NedCo.

The problem was that in a merger situation the trustees had an obligation to do their best by the pensioners, and the group of widows concerned were outside the remit of RemCo and Court. The scheme had a surplus of almost £9 million and contributions have been suspended for the forseeable future, so there was plenty of money. The cost of the increase in benefits would be £1 million. There were issues involved concerning the public face of the Bank and the independence of the trustees, and he believed it was a muddle.

In response to a suggestion by Dame Sheila that uprating was a separate issue for a later Court meeting, Sir Chips said that that would pre-empt the rights of the trustees. It was not possible to discuss the merger while pre-empting what was going into the new Scheme, and he could not accept that. Mrs Heaton said that if there was a merger of two sets of trustees into one, then both groups must look at the positions of their members and resolve outstanding issues before the merger. As a trustee for the Staff Fund, it was necessary to look at whether taking extra members was acceptable for existing members. The trustees were trying to do their duty in terms of the decisions they had to take before the merger. Sir Chips said that he agreed with Mrs Heaton that it was not possible to agree a merger before sorting these issues out. Sir David Cooksey noted that there were two Schemes, one for Senior Executives, who were difficult to recruit. One way to deal with that was to have special provisions for accruing pensions more rapidly. It was naïve to think that, with a highly unionised workforce, the two schemes could be kept entirely apart without the Union looking to take an interest in the benefits executives could achieve. This was a risk he found discomforting.

Mr Keynes said the benefit structure was entirely in the hands of the Bank, not the trustees, who were responsible for managing funds. The basis for the Court Pension Scheme was already disclosed in the accounts. He did not believe concerns were so great. The unions had the right to the information and it was published in accordance with disclosure guidelines. Sir David said that the information was not highlighted in the accounts.

Mr Stretton said that a merger was not a particularly big deal in cost savings and those were not the essence of the decision. There was an issue of the rights of trustees in a combined Scheme. If the benefits of one class of member increased at the expense of the other then the trustees of the combined fund did have an interest. The likelihood was not great, but the trustees did have the right to discuss the issue of an increase in benefits even if they did not have the right to veto it.

Mr Hawker said he would prefer to leave a merger until the benefits issues had been resolved. Dame Sheila said that the prior issue was whether to merge and that was what should be decided. Mr Hawker said in principle it made sense to defer it until Court had heard the implications. Mrs Heaton said that in the light of Mr Stretton's comments she shared Sir David Cooksey's misgivings. Sir Chips Keswick said he would vote against a merger and Sir David Cooksey agreed. Sir Ian Gibson said it needed considerably more thought and discussion. If there was a joint fund there could be a perception that the largest group of people were subsidiary to an elite smaller group. It should not be undertaken in a rush.

Dame Sheila said she took the sense of the meeting to be that the Bank should not go ahead with the merger but might come back at a later stage when the technical issues had been exposed.

The Actuary's Recommendation

Sir Chips Keswick presented a Report from the Trustees of the Court Pension Scheme which included a Recommendation that in the light of the substantial surplus of assets over liabilities within the Scheme, the Actuary had recommended that there should continue to be a full contribution holiday with the Trustees meeting current expenses from the Scheme. The Trustees agreed with this proposal and in accordance with the Pensions Act 1995, sought the agreement of the employer, ie Court.

The Recommendation contained in the report was APPROVED.

Sheila V Masters

20/10/99

Peter Rodgers

20.10.99

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 OCTOBER 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 Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Sir Ian Gibson

Mr Hawker

Mrs Heaton

Sir Chips Keswick

Ms McKechnie

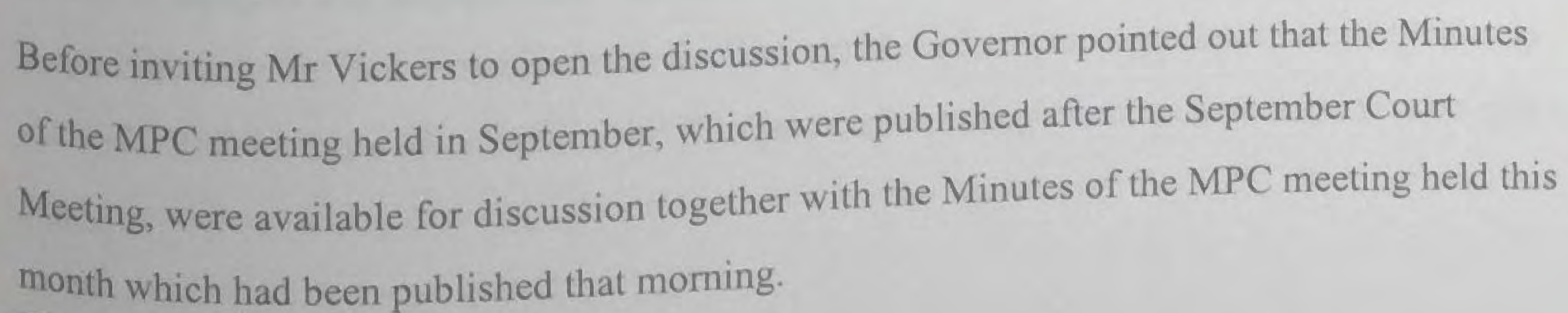
Mr Morris

Ms Kathleen O'Donovan

The Minutes of the Court of 15 September, having been circulated were approved.

MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Vickers, Plenderleith and Clark together with Profs Buiter and Goodhart and Drs Julius and Wadhwani in attendance)



Before inviting Mr Vickers to open the discussion, the Governor pointed out that the Minutes of the MPC meeting held in September, which were published after the September Court Meeting, were available for discussion together with the Minutes of the MPC meeting held this month which had been published that morning.

Mr Vickers, in introducing the discussion, referred to economic news which had been published since the September Court meeting. In the US, the Federal Reserve had held interest rates unchanged but had adopted a bias towards tightening. Producer prices in September showed their largest increase since September 1990 but consumer prices, which rose by 0.4% in September, remained in line with market expectations. In the euro area, GDP growth in the second quarter had been revised up to 1.6% per year indicating modestly strengthening demand but forward-looking indicators were stronger. In the UK, GDP had been revised up for both Q1 and Q2 and in the latter quarter was up 1.4% on the year but final domestic demand had risen by 4% with the wedge explained by the negative trade position and de-stocking. In Q3 indicators for industrial production and manufacturing showed a return to positive growth and survey evidence had been strong, not only for domestic production but also for exports. The CIPS services survey and the CBI distributive trades survey had both been reasonably strong and although retail sales in the 3rd quarter were up 3.4% on a year earlier, overall consumer demand was growing at a faster pace. The latest NIESR estimate for output in the third quarter was up 0.8% on the previous quarter. The labour market showed further evidence of tightening with the employment rate at its highest since the spring of 1990. The headline earnings figures had risen to 4.9% for the economy as a whole but remained at a more modest 3.6% for manufacturing. Producer output price inflation was 0.6% in the third quarter over the previous quarter, mainly due to increased petroleum product prices. Consumer price inflation remained quiet with RPIX unchanged at 2.1% but there was still a large wedge between the growth of prices of goods at 0.5% and those of services at 3.6%. For the upcoming forecast round, developments in profit margins would be a key issue.

Commenting on market developments, Mr Plenderleith said there had been little change in trends. The dollar looked a little weaker on expectations that the US economy would slow but the euro remained sluggish and the Japanese authorities were resisting a further appreciation of the yen. Sterling had appreciated against the weaker dollar and at time had seen strong demand related to mergers and acquisitions. Mr Plenderleith referred to the millennium spike in three month interest rates in the main currencies although the effect was seen less in sterling than in the dollar and the euro. But looking at UK repo rates he was pleased to note there was no spike at all.

Mr Bailie agreed that the economic climate was steadily improving. The biggest problem for businesses was in pricing; improving technology was leading to greater international competition which created tremendous pressures to keep output prices stable despite the problem of rising raw material costs. On house prices, he doubted that the 0.25 % increase in interest rates in September would have much effect as people were locking into fixed rate mortgages.

Mr Buxton agreed that the picture on sales was improving but pressure remained on corporate profits. There was a significant improvement in confidence in the housing market with 60% of householders expecting the value of their property to rise and an increase in the number of people expecting to move homes. Although demand pressure was clearly increasing inflation was being held back by the pressures on profits. The considerable rise in oil prices would be bound to affect retail prices sooner or later.

Ms McKechnie gave Court an indication of the results of the Consumer Association's fourth quarter consumer confidence survey. It found that most consumers expected the rate of inflation to be constant over the next year although expected house price inflation had increased from 2.2 % to 4.1%. Although the planned rate of saving had declined, there was a small increase in the proportion of people saving because of fears about the future and three quarters of consumers were concerned about increasing their debt over the next year. In general there was an increase in consumer confidence but it was not rising at a rate which would cause concern.

Mr Morris noted the increase in earnings in the services sector but was concerned that the Treasury were expressing the view that the only way to control excessive wage increases was through higher interest rates. He felt there must be a balance debate that did not abandon other tools of economic policy.

Sir Chips Keswick was not concerned about pressures in the housing market, noting that the forward market in new building was falling away and that business conditions in the property market outside of the M25 were not as good as last year.

Responding to these comments, Mr Vickers noted that the reality of pay settlements was not so worrying as some newspaper headlines would suggest. There was no sign of a sharp increase in pay settlements but there was now, perhaps, a looser link between settlements and earnings. The MPC did not seek to control house price inflation directly but set interest rates to control inflation as a whole. He appreciated the comments by Sir Chips Keswick on housing market prospects and by Ms McKechnie on consumer confidence and agreed that the situation for both looked steadier now than it had been in the late summer.

Draft responses to the Treasury Committee and House of Lords Select Committee Reports (Messrs Vickers, Plenderleith, Clark and Rodgers together with Profs Buiter and Goodhart and Drs Julius and Wadhwani in attendance)

The Governor asked Court to note the MPC's paper giving its response to the Treasury Select Committee report, "The Monetary Policy Committee - Two Years On." The Secretary had co-ordinated a draft response to the points made by the Treasury Committee and the House of Lords Select Committee concerning Court and NedCo. The draft response was agreed without discussion.

Opinion Polls
(Messrs Vickers, Plenderleith, Clark and Rodgers together with Profs Buiter and Goodhart and Drs Julius and Wadhwani in attendance)

Mr King reminded Court that the Working Party on a constituency for low inflation had recommended that the Bank pursue the idea of commissioning opinion polls. Three polling companies had been short-listed and NOP had been selected. They had designed a pilot questionnaire which had tested questions on a small audience and resulted in a modified questionnaire being prepared for a first complete survey in November. The survey would be held quarterly but the first year would be a trial period to check the usefulness of the questions and the responses. After a year he would bring a paper to Court reviewing the results of the surveys.

The Governor said that the Bank would resist pressures to publish the results until it was satisfied that they were reliable. However, Mr Buxton thought that early publication with an explanation of possible short-comings might be preferable to resisting any publication at all.

Ms McKechnie warned that people did not always answer honestly. It was sensible to refine the survey methods so as to get at what consumers actually do rather than what they say they do. There should be at least two dry runs before any consideration could be given to publishing results. Mr Hawker suggested an early public commitment to publish the result some time in the future. The Governor was keen to establish a benchmark for assessing these surveys. He felt that in a year's time, with the completion of four surveys, we could judge the stability of the survey results.

Sir David Cooksey wondered if the survey would shed light on regional differences of view. Mr King responded that the survey population would be large enough to show the differences between England and Scotland but would not give finer regional distinctions. Of course, extra surveys could be done in a target region if that were required.

Dame Sheila Masters noted the problem of cutting out noise in the surveys. For example, when people read about rising house prices it could affect their response to questions irrespective of their personal experience. Mr King explained that the survey would be collected in the period after the publication of the Inflation Report as this was a quiet period for economic news and press coverage of the Report was usually measured and even. But a record would be kept of news events in the period ahead of polling in order to see if they were distorting the responses. Finally he noted that the preliminary poll had found a higher degree of recognition of the Governor and the MPC than NOP had expected.

Non-Policy Meetings of the MPC – quarterly update
(Messrs Vickers, Plenderleith, Clark together with Profs Buiter and Goodhart and Drs Julius and Wadhwani in attendance)

Mr King drew Court's attention to the quarterly update list of non-policy meetings of the MPC. Referring to the meeting on Office for National Statistics Priorities, Dame Sheila Masters asked what were the MPC's concerns and what was the outcome of the meeting. Mr King explained that a service level agreement between ONS and the Bank had been signed and as a consequence each March the Bank would discuss with ONS their priorities for the coming year. There had already been a preliminary discussion at which the Bank had referred to the need to

develop better data on service sector output and productivity. A detailed paper would be put to Court in the Spring.

FINANCIAL STABILITY ISSUES

Review of the Financial Stability area, including domestic developments and international issues (Messrs Clark, Plenderleith, Vickers and Tucker in attendance)

Following a request made by NedCo the previous July, Mr Clark had produced a paper which reviewed the work and responsibilities of the Financial Stability area.

In introducing the paper, Mr Clark said that over the past two and a half years the greatest threat to financial stability had come from international developments. At the beginning of that period, the FS Area had had few staff looking at international issues; but the number had been built up over time and the Area now had greater capacity for country analysis and for the analysis of developments in the so-called "international financial architecture." Elsewhere, Mr Clark drew attention to his Area's work on small firm financing and the annual report which had been produced for several years. The emphasis was switching now to the question of venture capital for small companies. There had also recently been a special report on the financing of ethnic businesses. On a different tack again, the FS Area's work on millennium preparations had attracted a lot of publicity, partly stemming from the publication of six "blue books", the most recent of which had been published the previous day and focussed on contingency planning, market liquidity and banknote availability over the millennium weekend. In addition, Mr Clark noted that the Financial Stability Review had been developed during the past year with a more in-depth assessment section and a greater range of articles. At present the Review was half-yearly, but consideration might be given to making it quarterly at some stage.

Mr Clark concluded by noting that financial stability issues are usually less familiar that monetary stability issues, and that a key objective of his area was to explain financial stability risks and policy issues more fully.

Mr Tucker spoke of the need to emphasise the focus on the FS Area's business aims. There was also an on-going effort to raise the quality of the financial stability staff. The area needed a mix

of skills: macro-economics; finance theory; market experience; institutional knowledge of the financial system. Therefore there was a move towards niche recruitment. The area had recently been twenty staff below budget but he hoped that by the end of the year this would be reduced to five below budget. In an uncomfortable number of cases the Bank had been unable to recruit staff because of uncompetitive pay, with the higher salaries paid by international institutions being a particular problem. On IT, there was a need for better data management systems. A new senior manager had been appointed to drive forward the FS Area's IT strategy.

Mr Buxton felt that IT management should be a priority. Mr Tucker and Mr Clark agreed.

Mr Buxton noted the Bank's good reputation for providing external training in the financial regulation field. Mr Clark said that this was now largely a matter for the FSA; but the Bank continued to work closely with the FSA in this area, with the CCBS playing a key role.

Sir Chips Keswick warned of the danger that work on financial stability could become too academic and lose contact with the "real world" operation of markets. He suggested that for experience, junior staff should be seconded to City firms. Mr Clark agreed but noted that while staff shortages remained it was difficult to manage outward secondments. Mr Plenderleith reminded Court that the Bank retained close contact with some markets through its dealing operations.

Sir David Cooksey was concerned about developments in capital markets. New technology called into question the continued existence of traditional stock exchanges at the same time, trading was tending to concentrate on the more liquid stocks. This in turn led to a declining flow of research on less liquid stocks from brokers. In addition there seemed to be a diminishing volume of public issues and an increasing problem of lack of liquidity of the stock of smaller companies which made it difficult for them to expand. Mr Clark noted that there were a whole complex of issues on small company finance and that one of the Bank's objectives was to put them into a more organised framework. The Governor pointed out that the annual report on small business finance would home in on these multi-faceted problems.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues
(Messrs Plenderleith, Vickers and Clark in attendance)

Mr Plenderleith drew Court's attention to the statement on gold sales by European central banks which had led to a marked price rise and, hopefully, a return to more stable trading conditions. The sharp price rise had squeezed bears but had created problems for mining companies such as Ashanti which had a large volume of outstanding forward sales on which they faced margin calls. The Bank was keeping closely in touch with the Ashanti situation. In the longer term the Bank's hope was that gold market conditions would more realistically reflect underlying supply and demand fundamentals. Sir David Cooksey said that the Bank of England was widely regarded as having helped restore stability to the forward market for gold.

Mr Plenderleith also drew Court's attention to the press release put out by the Bank of England on 20 September regarding sterling market liquidity over the millennium change period. He said that the announcement had helped to calm market fears and reassure participants that sterling markets would be able to operate over the turn of the millennium in an orderly fashion. Mr Plenderleith noted the passage in the latest "blue book" describing the scale of banknote availability over the millennium weekend.

The Governor mentioned that he was aware that Mrs Heaton had expressed some concern about matters relating to the latest rise in interest rates which, she felt, had taken the market by surprise and he offered her the opportunity to raise the issue at Court. Mrs Heaton said that the last interest rate rise was greeted by surprise in the market which reflected press reports concerning two MPC members who appeared to favour no change to interest rates. She was not aware of people in the markets making serious losses but felt the Bank might be criticised if public statements were inconsistent with actions.

The Governor said that the August MPC minutes showed that although the Committee had been unanimous in leaving interest rates unchanged there were in fact three underlying different points of view. Market commentators who were surprised by the September decision had not looked at the detail of the earlier debates in the MPC. He felt that the September events had

been a learning experience for the market place and he hoped that commentators would be more perceptive in future. However, there were bound to be occasions when the market failed to anticipate the MPC's decisions.

EXECUTIVE REPORT
(Messrs Clark, Plenderleith and Vickers in attendance)

The Governor advised Court that following Court's discussion the previous month, when it was decided not to proceed with a merger of the two pension schemes, Sir Chips Keswick felt it inappropriate to remain as a trustee of both schemes and was therefore standing down as a trustee of the Staff Pension Fund. Mr Morris had kindly agreed to rejoin the Staff Pension Fund in place of Sir Chips and the Governor sought Court's endorsement to the changes.

The Governor drew Court's attention to the note Mr Rodgers had circulated on the arrangements for Court in Edinburgh in January, outlining proposed events and timings. The Governor advised Court that they would be kept informed of further progress as plans firmed up, but invited questions. With regard to those events being organised on the afternoon of the Court meeting, he invited non-executive Directors to speak directly to Mr Rodgers concerning the events which they might like to attend alongside members of the Executive.

Mr Clementi said that the Bank had had an approach from the Lawn Tennis Association (LTA) about whether part of the Sports Club could be released to provide a national centre of excellence in tennis. The LTA would move part of its headquarters from Queen's Club to Roehampton. There would be some dedicated facilities but they would also share some of the Bank's facilities, particularly catering. This was a sensible proposal but there were "caveats". Council planning permission had to be obtained and negotiations had to be completed to ensure that a proper income was received from the LTA. The Bank had asked for an initial payment of half a million pounds. Both conditions had to be matched if the proposal was to go ahead. In many respects it would suit the Bank quite well. The Governor noted that the International Lawn Tennis Federation already had a facility at the Sports Club.

Mr Vickers said that Professor Maxwell Fry had stepped down from the Centre for Central Banking Studies and Professor Peter Sinclair would be appointed in his stead in the new year

on a four day a week basis. He was a wide ranging economist who had worked in monetary and international economics and in many other branches of the profession.

MANAGEMENT OF THE BANK

Finance

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

Mr Midgley said that on the income side there had been no real change in the totals but there was an emerging difference in the composition, which was explained in the cover note. On the expenditure side, the budget was £11mn underspent in the first half relative to budget, against £8mn underspent in the first quarter. The forecast underspend for the year was £8mn which implied that in the second half the Bank was going to spend £3mn more than the second half budget. One quarter ago the Bank was underspending by £8mn and was saying that the rest of the year's overspend would be £3mn leading to an underspend of £5mn for the year. There had been another £3mn of underspend and that had been taken in to the total for the year. He said there were a number of explanations for the turn round between the two half years. The pattern of production at the Printing Works varied between the two halves. There was also a more realistic estimate of the likely cash bonus to staff, which accounted for £2mn of the turnround. Another £4mn was associated with IT and investment spending. Sir David Cooksey asked whether, having seen the advantages in having an extra issue of notes for the millennium weekend, this was going to be offset next year after the millennium. Mr Clementi said that this was a good question. The year would start with a very much larger stock than usual. The Bank was discussing the production run proposals that it would bring to Court in February. The preliminary proposal was 1.1bn notes, which was quite a bit less than this year, but this would be reviewed again in January. In response to a question from Sir David about how the Bank would control costs at the Printing Works, Mr Clementi said that further productivity gains were expected, but whether they were through redundancies or natural wastage would have to be seen.

Dame Sheila said she was slightly concerned about the weakening mix of staff in Monetary Analysis. Although the numbers were up there was a shortage at senior level. Was the end of this problem in sight? Mr Vickers said he hoped so but he was not sure it could be seen very clearly. He was reasonably confident with what had been done on recruitment, for example with MScs, and the Bank was pushing hard for more experienced staff, and had recently advertised in the Economist. The problem was quite acute. After the November Inflation Report the report team would more or less disperse, and he was not at this stage sure who would be preparing it in February. It would be done of course but he was not sure how. The Bank had to recruit more experienced staff and had to perform better at retention. It was not just a question of retention in the sense of outside jobs, but of intra-Bank transfers as well.

In response to a question from Dame Sheila about whether certain activities were not being carried out, Mr Vickers said that Monetary Analysis was not getting everything done it would like to, and there were some clear areas in which it would have liked to have done more. Progress had been made on policy towards retentions and there was some rebanding a few months ago. The annual salary round would be an opportunity to attack that dimension of the problem.

<u>Other</u>

Mid Year review of performance
(Messrs Clark, Plenderleith, Vickers, Footman and Midgley in attendance)

Mr Footman, introducing the progress report on the Bank's objectives covering the period March-August 1999, said that there was only one area in which there was a complete withdrawal of an objective, and that was the Printing Works, which had not proceeded with an external contract as a result of Year 2000 pressures. Referring to the traffic light symbols, Mr Footman said that a number were orange and these could in many cases be traced to the sort of issues that Court had just been discussing, for example shortages of staff and of experience in Monetary Analysis. This issue also arose in Financial Stability where there were shortages in Financial Institutions and one or two other areas. The levels of experience in both MA and FS were weak. Turning to retention, he said there had been a number of resignations, though not at a rate that bore comparison with some previous years. However there were a number of areas that could not afford to lose people. The pay review would be looking very hard at how

money could be skewed to these areas. Turning to the Personnel Department, he said it was intended to make career development a stronger objective for the next year. One task which was more or less complete and was about to be launched, on 2 November, was the staff benefits review. He and Mr Clementi would spend a week presenting it to staff. Proposals were broadly the same as those shown to Court, but tightened at various points, including a re-examination of the trade-off between benefits and mortgage compensation. The main issue, he believed, would be a reduction in the number of days leave. However, the benefits package would be very attractive for some, particularly the young professionals working in areas where the Bank had retention difficulties. The Bank would be offering to negotiate with the Unions on the proposals at the same time as they were presented to staff, but would stick to its guns on the broad package. He proposed saying that the package had the support of Court.

Dame Sheila, returning to MA objectives, noted their importance for the review of the MPC's procedures next year. She asked what would be involved in reinstating the ability to deliver on the objectives. Mr Vickers said that the orange indicator referring to the work programme of the Structural Economic Analysis Division resulted from the Division being way below budget. The big pushes on recruitment and IT both involved managers in that Division. The work concerned was on the structure of the labour market and price and margins issues. It was not blue skies work but practical. In another area, business aim number 6, the indicator was not orange but green, because the models had been published, but not as much continued development had been done as he would have wished, and the people involved, particularly in forecasting, had been under acute pressure. Such shortfalls and under - achievement did matter.

The Governor commented that notwithstanding those remarks, the quality of the product of Monetary Analysis was going from strength to strength, and there had been no impact on the monetary policy process up to that point. Ms O'Donovan asked whether the Bank carried out exit interviews. Mr Footman said that this was done in Personnel, not by line management, and the results were shared. The interviews threw up a variety of explanations for departures, including a more challenging role elsewhere in the City, and the people concerned kept saying that pay was not an issue, which Mr Footman believed might be partly true, but it was difficult to believe was entirely true. The issue within several of the areas in the Bank was that people saw their career opportunities limited to those areas. It was tricky to do much about that when

particular areas were short staffed and development of people's careers took them away from where they were most needed.

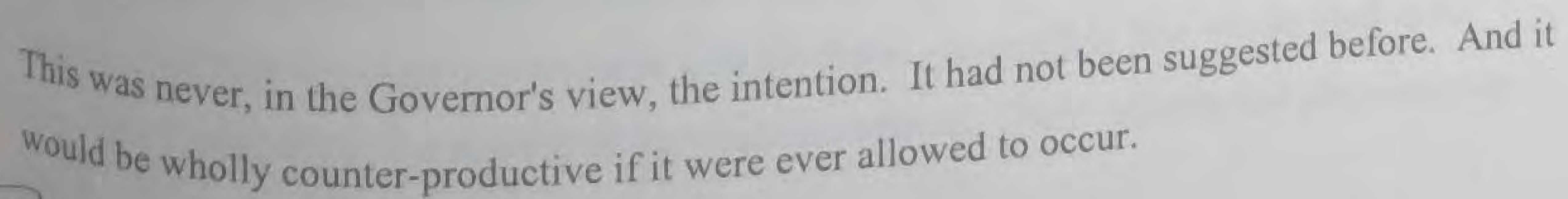
Report on the Senior Staff Conference
(Messrs Clark, Plenderleith and Vickers in attendance)

Mr Clementi said that the Bank had held its fourth annual Senior Staff Conference on the Wednesday of the previous week. The Conference had addressed some of the strategic issues facing the Bank in the future. Mr King had presented a paper on building a constituency for low inflation, Mr Clark had presented a paper on e-commerce, Mr Midgley had presented a paper on IT issues, and the longest session in conference was based on a paper by Mr Townend on the consequences for the Bank on euro entry. The staff conference was intended to inform the strategy setting process. The general themes were to reduce costs and produce a more flexible workforce, and on the policy side, to build centres of excellence which would benefit the Bank were the UK to go into Europe. These issues would be returned to in November when he presented the strategy paper to Court.

Support for the independent MPC members

The Governor noted that all Directors had seen the paper produced by the independent members of the MPC on MPC resources, and a number of Directors had had the opportunity that morning to discuss it with them. He felt that it would be wrong for him to intervene before they had had that opportunity.

At one level, the paper was written as if the issue were one of principle – the principle of the independence of its authors on the MPC. They appeared to see their role as an independent counter weight to the MPC members who were executives of the Bank, who implicitly acted collectively. The process, on this view, was one of "them and us".


This was never, in the Governor's view, the intention. It had not been suggested before. And it would be wholly counter-productive if it were ever allowed to occur.

All nine members of the MPC were clearly appointed in an individual capacity and were independently accountable for their contribution to the policy decision-making process through the publication of their votes. The objective was a process, informed by their individual expert opinions, which was independent of government. That independence of government was the explicit purpose of the TSC's confirmation hearings of all nine appointments.

And that was exactly how the process worked in practice, with each member (not just the "independent" members) deliberately encouraged to take independent positions, whether on the policy decision itself, or on aspects of the forecasts, or drafting of the Inflation Report, or on procedures and processes, or on the use of resources supporting the MPC's work. The result, in all the MPC's collective decisions, had invariably been a constructive give and take between all members of the Committee – and this had hitherto been generally recognised both within the Committee itself, and by outside observers.

The idea that the "independent" members should be supported with a large research capability of their own, accountable to them alone, in order to enable them to challenge a supposed "Bank view", never to the Governor's knowledge featured in the debate leading up to the new arrangements and was not reflected in any of the texts that established those arrangements. More importantly, it would fundamentally change the dynamics of the process. It would create an adversarial "them and us" environment and make the process unmanageable, in the Governor's view.

At an altogether different level, the paper was about the much narrower issue of the personal support available to individual "independent" MPC members on the one hand, and their individual capacity to influence the priorities of the MPC's (necessarily limited) collective research capacity in Monetary Analysis on the other. The Governor had more sympathy for their concern on this score.

It was originally envisaged that the "independents" would be able to access MA sufficiently for them not to need personal technical support. But the Governor said the Bank under-estimated the effect of their full-time involvement with the Bank – something that would need to be considered carefully in the context of future appointments. Their requests had progressively

escalated, so that the orderly management of the workload in MA had become increasingly more difficult.

The Governor therefore proposed to address these more limited concerns as follows:-

1 Each externally-appointed member of MPC would have their own qualified personal assistant recruited on contract for the term of the MPC member's appointment. The details of this arrangement were set out in a note for Court from John Footman.

2 MA – insofar as it was working for the MPC, which was not the whole of its work – was there to meet the collective needs of the MPC not the particular needs of individual MPC members.

Of course it was reasonable for individual MPC members – through their personal assistants - to seek MA's assistance where that did not involve significant calls on MA's resources. Such requests should be made via HoDs who would do what they could to help but who were instructed to decline requests which could not readily be met without diverting resources from the tasks set for their Divisions in support of the work of the MPC as a whole.

3 These arrangements, of course, meant that the MPC as a whole must be in a position to influence the work priorities of MA insofar as it was working as a collective resource for the MPC. To a degree this already happened quite naturally in the context of the monthly process, where information points arose at pre-MPC; and the MPC as a whole was engaged in the review of the pre-MPC process. It also happened to a degree in the context of the quarterly forecasting round, which recognised the overall pressure that the team was under and when agreement was usually managed without formality on the immediate priorities.

4 Some issues, however, arose in the context of the forecasting round which required more extensive work by the forecasting team or by others in MA and which could not be immediately addressed. In future the MPC would hold quarterly meetings following the forecasting round at which it would review together those issues or other forecast related issues that individual MPC members cared to raise, and determine work priorities for the following

round and beyond. These meetings would be properly documented and the collective decisions recorded.

5 In addition the MPC would have regular annual meetings of the MPC to establish more substantial research priorities, including research priorities suggested by individual MPC members. These meetings, too, would be properly documented and the collective decisions recorded.

6 Finally, where an externally-appointed Committee member was to be involved in a collectively–agreed MA project of either kind – as the Governor very much hoped they would continue to be – specific individuals within MA would be nominated, and dedicated, to work with them on that project.

Mr King said he strongly supported the Governor's proposals and on a personal note he also believed that the Governor had shown great patience. The concept of an independent member was a misnomer in that all members of the MPC were independent in their votes. But the Act contained no adjectives describing the external members. However, the five internal members were defined by their executive role and the external role was defined implicitly by that. The only other definition appearing in the Act was that the external members were servants of the Bank. The work of the MPC members, narrowly defined, took up approximately half of their time. The issue was how the rest of their time should be spent. Executive members had executive responsibilities and the question was what should the externals do within that time. There could be a number of possible answers to that question. They could be given executive roles, they could spend time outside London promoting the case for low inflation around the country, they could have a role in drafting the Inflation Report. The question posed a real problem.

Mr King commented that, contrary to the suggestion that the arrangement now was only suitable for academics, the proposal by the externals would set up an arrangement that was indeed only suitable for academics. It would create a university of Threadneedle Street. It was an attractive option for the externals, but he could not believe that a non-academic would find this a rewarding way to spend time. The Governor's proposal would give the externals more time to do work on monetary policy than the internals whose Private Secretaries were occupied

almost exclusively with work arising from their executive responsibilities. Finally, the key to the issue was who manages Monetary Analysis. The Bank was held in enormous esteem for the quality of monetary analysis. A senior Japanese Ministry of Finance official had written in the Financial Times earlier in the week that the Bank of Japan might adopt inflation targets, Bank of England-style. That was not an accident. There had been a very clear vision of what the Bank wanted to create and a clear management structure to produce it. Success in that area would be at risk if the Bank had collective management of these resources. If the resource was free there would be infinite demand for it. Monetary Analysis could not be successfully managed by the external members. The quality of the team would not survive under collective management. The Governor's proposals included further ways of attempting to decide the priorities of the MPC in a collective way. He noted that the process of reaching decisions on interest rates had gone extraordinarily well, but the external members' ability to contribute and vote had not been remotely compromised by a lack of access to resources. In many ways the external members had more time and resources than were available to the executive members. The Governor's proposals were sensible and would put all members on an equal footing. To create an independent research division for the independents would do the opposite.

Mr Clementi said it was necessary to recognise that there was a real problem, whether it was justified or not. The externals did not feel they had a sufficient say in the work priorities of Monetary Analysis. He agreed with much of their analysis but not with the solutions or the conclusions. The principle was that Monetary Analysis was there to serve all nine members of the MPC and not just the five Bank members. The five never met as a group to discuss these issues. The concept of the four having access to independent resources went against that. If Court conceded the point, he did not believe it would stop there and each individual would eventually want his or her own resources.

On a practical point, a separate research unit would create two research units in the Bank and might lead eventually to nine. Certainly in the first instance there would be a division into two, and that was a very real practical objection for him. Having said that, it had to be recognised that there was a need for a solution because the status quo was not sufficient. The Governor had put forward a proposal that in his view met those needs. It would provide a much more formal and transparent process, in which all nine members of the MPC could influence the work, and he imagined that the document that resulted would come to Court. It offered a

Private Secretary each, it put the external members on a par with the executive members of the MPC. So he supported the Governor's proposal.

Dame Sheila Masters summarised what the external members had said to the non-executive Directors. They had represented this as an extremely serious issue which compromised the independence and effectiveness of the MPC. Court should be under no illusion about the strength of feeling among the independent members, who believed they were excluded from the process of discussing the resources available to them and from other discussions about how resources were used, particularly in Monetary Analysis. She did not believe the external members understood the Governor's proposal, and she did not think they would see it as solving the problem. They did not want personal support, rather they wanted intellectual support. Indeed, they had described the issue in terms of the Governor's proposals making things worse. They had emphasised that the only way they could use their time properly was by undertaking detailed research that could contribute to their work as MPC members, on items they thought were important work, but that the MPC as a whole might not necessarily think important. The external members saw themselves differently from the way they had been described in the previous remarks in Court. They saw themselves as being independent of the Bank.
Dame Sheila commented that there was a very wide gap between the external members and the executive members, it was a very serious issue, and that was what had come over in the morning meeting.

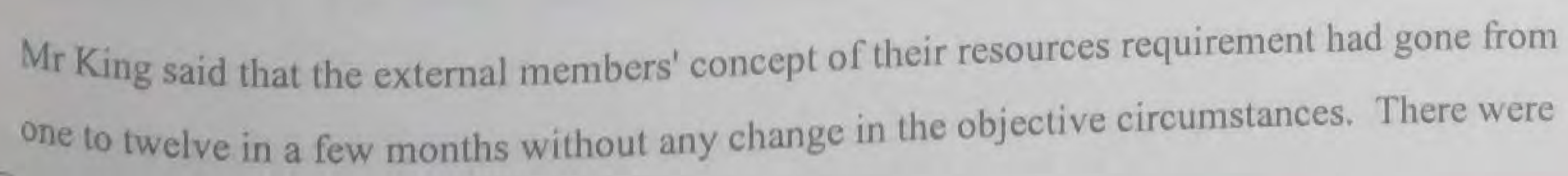
Mrs Heaton asked whether part of the reason external members had gone down the route of requesting independent research was a feeling that they had not sufficient influence over research within the Bank. She had put it to them that their demands could lead to the establishment of four different research departments for their own needs. They rebutted that by saying that if they had four different priorities, they could settle them between themselves, because their culture would be more of an academic approach to resources, which contrasted with the more controlled arrangements in the institution of the Bank of England. If that approach was anathema, the only other way to move was for them to have more influence over research priorities in the Bank.

They called themselves independent because they felt outsiders. They felt second class citizens, or pheasants with their wings clipped, because they did not have the resources to do

research to reinforce their views where there were differences from the institutional view. At the Treasury, where Mrs Heaton had worked, there was great room for differences of view. The more that culture could be developed the more scope there would be for the externally appointed members to feel that they were pulling an equal punch. She felt that the way to move forward was to open up internally. She noted that the Governor had said that Monetary Analysis worked for the MPC, but not solely. Presumably when the independents debated the allocation of resources they could not debate the whole thing, so priorities would get fudged. She asked whether the MPC work should be divided from the non-MPC work and a budget set for the MPC side of it.

The Governor said that when the last Annual Report had been discussed the question of personal versus collective resources had come up. The collective resources had to be genuinely open to influence and as a result he had made clear that the external members were always welcome to call a meeting of the MPC to discuss such issues. There had been no such meeting requested. Yet the issue had suddenly exploded. His concern was that no advantage had been taken of the mechanism which had been put in to address such issues. Turning to Monetary Analysis resources, the Governor said that it would not be sensible to have a separate organisation to do the work required for meetings in Basle or of the G7. MA prepared briefs for him. That was what was meant by saying that Monetary Analysis did not work exclusively for the MPC itself.

Turning to the suggestion of opening up internally, the Governor said that this implied that people should be able to decide individually what had to be done. That ran counter to managing Monetary Analysis under the current arrangements. What the Bank would provide would be a forum in which priorities could be decided collectively. There would be a quarterly discussion, introduced after the forecasting round, and that was as far as the Bank could go. He commented that the external members saw their role as very different, and that perception was new. Before the summer, they had talked as if one qualified assistant would be an appropriate solution. The externals had said that they had not been party to the Governor's discussions, but he noted that he had not been party to theirs.



Mr King said that the external members' concept of their resources requirement had gone from one to twelve in a few months without any change in the objective circumstances. There were

no more than 20 full time equivalent staff working on research of the kind relevant to the resources required. The others were working on briefing and other work in Monetary Analysis. The request amounted to 50% of that resource for their own use, and they would still have a major say in the work of the other eight. Some of those 20 were already doing work for the external members, but the vast majority were doing work agreed as a priority for Monetary Analysis. Some were working directly to MPC members. It was not a process that was working well. The external members wanted the ability effectively to control large resources at short notice. There was no way that it would be possible to manage the research process by agreeing priorities at the beginning of the year and then accepting demands made week by week by the external members. Because there was no cost, the demand would be infinite. Remarkable forbearance had been shown by the internal members of the MPC. During discussions, to accommodate the wishes of the external members, the internal members had quite deliberately kept quiet and not pressed for their own requirements because of their concerns about the resource constraints. If there were a change, the internal members would have their own points to make on the issue. At present, their own wishes were subsidiary. The Bank had tried to put in a process where preferences for research priorities could be expressed. That had not been used, and where it had been used there had been no follow through at all.

Mr Morris said it was self-evident that the current relationship was not working to the satisfaction of the externals or the executive members of the MPC. They had made an opening statement giving - Mr Morris' said he was using his own words - a chronology of frustration, which highlighted the inertia of the internal bureaucracy, which they believed frustrated their efforts to perform the function for which they were appointed. The Governor's paper had explained the statement of principle, which might well be right, but how it was received was another point. The external members' opening statement had said that a lack of resources was inhibiting their ability to contribute to monetary policy. Whatever the motive and the underlying culture behind the paper, a statement like that had to be taken by NedCo as a statement of principle in some form.

The debate and the responses during the questions showed that there was some concern among NedCo members. The current disagreements might owe their origin to some structural inheritance over which Court did not have total control. He agreed with Mr Bailie that the proposals might be a manifestation of a symptom and not the underlying problem at issue. It

was a group which was given responsibility but had little or minimum control over the means of delivering that. In that context they felt a sense of frustration. NedCo wished to hear both sides of the argument. The conclusions of the externals' paper indicated that they had scaled back from a request for 20 economic staff to 12. Directors had two papers before them and those who had been at the discussion earlier in the morning would come to the conclusion that the gap between the externals' expectations and the Governor's proposals was extremely wide. None of the Directors had been persuaded at the morning discussion that the externals' proposals represented a solution appropriate to the organisation, but there was a general feeling that there needed to be an in-depth discussion of the issues, which had to find some sort of permanent resolution. He was not sure that accepting or endorsing the paper would lead to a lasting solution when there was a grievance put in such strong terms. Given that a public manifestation of the issues could have devastating consequences, there had to be a dialogue aimed at reaching solutions. It was not possible to say that Court had evaluated the problem, made proposals, and asked for acceptance. There had to be more of a consensus and more of an engagement than that. He believed that Court would have to find a proposal that satisfied the immediate needs of external members, but he would be unhappy if that was all Court did. He suggested that perhaps there should be a long-term dialogue, maybe centred on a paper in which the externals might be invited to participate, and not necessarily the paper before Court. There had to be discussions and negotiations. He proposed that the Governor, Dame Sheila and others should sit down with the external members to find an agreement that aired the issues, which was long-lasting and would not leave the impression in the air that the external members were in control or making unreasonable demands.

Sir Chips Keswick said he disagreed. The MPC was set up by the Government and given to the Bank to run. There was no concept of a consensus view and to how it should be run. The Bank of England's task was to make sure that it worked. He wondered whether the external members had read their briefs properly when they became members. It was too early for Court to be put in the position of having to take sides.

Mr Buxton said that it was very worrying for the non-executive Directors that the two positions had become so entrenched. Mr Morris was right in that the relationship had broken down in some way and that was extremely worrying for Directors, particularly as they were dealing with MPC procedures which needed to be as transparent as possible. There was a great danger that

if it was known publicly that some members felt that they were not getting the right resources it would dent public confidence in the process. That was a serious issue for the Directors to be faced with. From the point of view of the four external members, he wondered whether this was not a problem that arose from the structure and culture of the Bank of England which was very formal, and the external members found it very difficult to break into Monetary Analysis resources. As a result, they had said they would need to set up their own resources, but he believed that that would be very divisive. He would like each of the independent members to have a power base somewhere else, with an allowance for research. He conceded that it was impractical as a solution after this morning's discussion. The problem was that most of the external members were full time. They should have some dedicated resources within MA but not their own division. Then they would be able to break into the culture of MA and have work done for them. If they were going to be independent economists they would have their own idea of what research they wished to do. He did not believe the Bank could expect to employ people who would always agree to follow the consensus of the Committee.

Mr King said that the independents were not shy of making contacts with Monetary Analysis. The problem was not that they were not involved. Staff were saying that they had a number of people asking them to do things, and they wished to have a decision on which requests they should accept. There had been an attempt to make these decisions collectively, but that was not working. The mechanisms which had been set up would not work unless there was an agreement involving the internals and the externals - and having gone through a collective process members did not then ask for new work to be done the next week. If that kept happening it would not be possible to deliver the collective priorities. Mr Buxton thought that if Mr King came along with a proposal he was sure staff would put it right to the top of the list. Mr King said this was not the case, and the internal members did not come along to disrupt the existing workload.

Mr Bailie said it was very dangerous for Court to suggest solutions when it was not totally informed about the difficulties. It was common ground that the best information was made available for decisions on interest rates, but the external members believed, rightly or wrongly, that there was certain research that needed to take place that did not take place. The only way that was going to be resolved would be by the nine MPC members sitting around a table, at the end of that discussion to at least agree on where they disagreed.

Ms McKechnie said that the Governor was in an impossible position from a management perspective. Directors had enormous sympathy for the situation he had been put in. The problem was that the structure was fundamentally flawed. It did not matter what the fundamental principles were, since the external members clearly saw their side of the argument quite differently from the Bank members. Dr Wadhwani, the most recent member of the MPC, had said that these were not the terms on which he accepted the job. The nightmare was that the external members quite clearly felt so strongly that a number of them might say they were not willing to accept the situation, and might go public or threaten to resign. Court would then be faced with a meltdown which would undo all the benefits all the members of the MPC had so carefully nurtured in terms of an independent MPC, and all the benefits that had produced nationally. The Bank would also be exposed, in that context, to much international criticism. She saw only two ways out of the situation. The Treasury should not be allowed to pass the buck back to Court. The Treasury created the contradictions and must take a view on how to resolve them. That ought to be explored in a parallel process. Second, the easiest way to deal with the situation was to throw some money at it and to allow them to have independent people recruited for them at a level they were prepared to live with. Ms McKechnie said she acknowledged that the Bank executive might feel that this amounted to blackmail, and she understood the position that they were taking. Court had to try and protect the credibility of the process, and so there had to be a compromise. The Governor commented that if that was the case Court had a problem not just with the external members but with the internal MPC members.

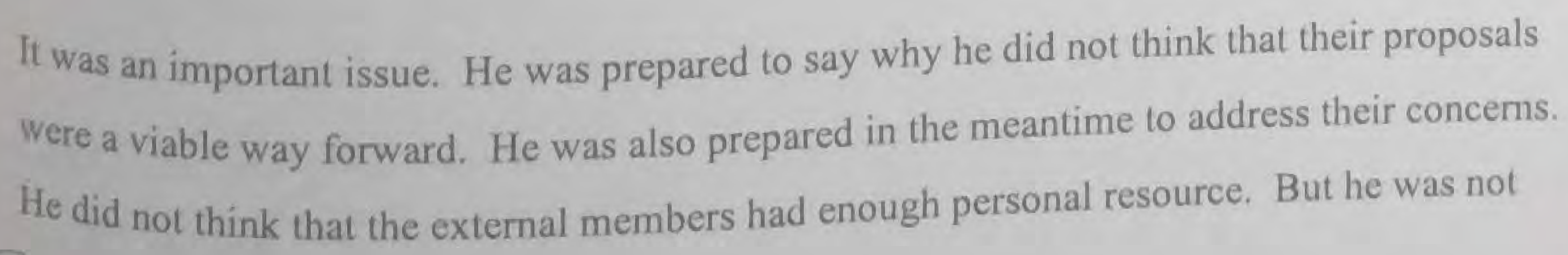
Mr Clementi said that the MPC worked on two bases, collectively and individually. Individually, they were responsible for their own votes. Collectively there was a question of resource allocation and any solution on this front had to be either collective, embracing all nine, or individual. It could not be five and four or seven and two. A solution for the four might exacerbate the problem. Mr Vickers and Mr Plenderleith would feel very strongly about it.

Dame Sheila Masters said that the non-executive Directors needed to look at the issue very carefully because only a few months ago they had signed off their report on MPC procedures. She had spoken to each member of the MPC and had asked specifically about resources. Dr Julius had only mentioned her concerns about the prioritisation of research projects and

Professor Buiter had only expressed concerns about the number of models to which he had access. There had been a significant shift since then. Court had to understand more about the shift. There had been concerns, but not at these levels, when NedCo's report was written.

Mr Hawker said there needed to be more dialogue on the MPC. It had been noted that the external members had not taken up the system which the Bank had put in place. That should be debated, and there should be a clearing of the air on the MPC. That stage should take place before Court's involvement. Mr Allsopp said he was concerned about why the situation had become so bad so quickly. The Act did not contain definitions of the roles of the externals or independents. So this was a problem waiting to happen. Some clearly regarded the role in a completely different way. Such a stand-off was extremely dangerous. He could see no way of resolving it other than by discussions. The problem was not caused by the Bank or the externals but was implicit in the way the MPC was set up, and was made worse by the fact that the external members had turned out to be mostly full time. The other issue was the cultural problem, in the sense that they felt excluded. He had no idea whether this was correct or not, but the problem was that they did feel excluded.

The Governor proposed, as a way forward, that the MPC would meet as a Committee of nine and have the dialogue that had taken place in two parts that morning. A report on the outcome would be made to the Directors before the next Court. He said he was concerned that the problem might run on, so that it would be months before it was resolved. He therefore proposed saying to the external members that they could either agree to continue with very limited resources until the question was resolved one way or another, or they could move ahead on the basis proposed by the Bank while taking part in the dialogue, and reviewing the arrangements further down the track. The Governor said that he could not manage a process where it was a question of them and us. It would take weeks to produce the external members' model, which would be contrasted with the Bank's, and there would be regular five to four votes on the Committee. It would destroy the dynamics of the process. He would not be prepared to participate in that.


It was an important issue. He was prepared to say why he did not think that their proposals were a viable way forward. He was also prepared in the meantime to address their concerns. He did not think that the external members had enough personal resource. But he was not

prepared as an interim measure to set up an alternative research department, given that the Bank could not staff the department it had already.

Mr Bailie commented that there was a great danger of divide and rule. He suggested that Dame Sheila sat in on the meeting as a Member of Court. The Governor said that he would be very happy if Dame Sheila would like to do that.

Sir Ian Gibson said that this was a board that had just heard that there was a major problem facing the executive and non-executive directors. A board could not walk away from that. The MPC must fix it, but the board could not allow it to be done behind closed doors. If Dame Sheila was to be delegated to attend the meeting, that should be debated. Court should say that some non-executive Directors should be at the meeting, not to listen but to offer views, and if necessary to offer solutions. There was some degree of right on both sides. There was some misunderstanding by the externals of their role. That should not be allowed to continue. It was easier and better for the non-executive Directors to make that point than for the executives to make it. The boil had to be lanced.

Sir David Cooksey agreed. There was a real possibility of the issue boiling over into the public domain. The Governor said that in that case he was quite prepared to make his position clear. Dame Sheila said that Court would prefer that not to be in public. The Governor said he would arrange a meeting of the MPC with Dame Sheila, and if Dame Sheila wished to touch base with others who wanted to come to that meeting he would be content. The meeting would confront the issue of independent membership of the MPC. As an interim step the Governor said that he would like to suggest that Court adopted the limited resource proposal that he had put forward. It was not a matter of degree but of principle. It was a matter of whether there was an alternative research centre to the Bank. Court was content with the way forward proposed by the Governor.

Sheila V Masters

17 November 1999

Peter Rodgers

17.11.99

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 NOVEMBER 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 Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Mr Davies

Sir Ian Gibson

Mr Hawker

Mrs Heaton

Ms McKechnie

Mr Morris

Mr Neill

Ms Kathleen O'Donovan

Sir Neville Simms

Mr Stretton

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

Inflation Report together with the economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Plenderleith, Clark and Jenkinson together with Drs Julius and Wadhwani in attendance)

In introducing the minutes of the meeting of the MPC held in the first week of November, which had been published earlier that morning, and the Inflation Report which had been published the previous week, Mr King said that the past year had seen remarkable changes in

economic conditions. Economic downturn and the shock waves from global financial crises had resulted in a sharp fall in business and consumer confidence in 1998, to levels comparable with the early 1980s. But the situation had turned around. Confidence had recovered and the recession index – the number of references to recession in the press – had fallen from a peak of 580 to around 120. The world economy was growing, reflecting recovery in emerging markets, rising growth in the euro-zone economies and continued strong growth in the US. In the UK, domestic demand was buoyant, growing by around 4.5% over the year to 1999 Q2. Overall, output had increased faster than expected at the time of the August Inflation Report while inflation was lower than had been expected. Mr King said that the extent to which inflation had been suppressed was significant alongside continued tightness in the labour market.

Mr King drew Court's attention to the GDP and inflation forecasts shown in the fan charts. He said the MPC's forecast was for GDP growth to be higher and inflation to be lower than that presented in the August Inflation Report. The MPC expected inflation to fall further, in part reflecting the effect of lower utility prices next year and also the impact on profit margins of intensifying competition in the retail sector. Though there was little hard evidence to judge this effect, the Committee had felt it appropriate to build into the central projection a judgement about the impact of greater competition on margins and prices. This amounted to a reduction in inflation of around 0.2 percentage points in both years of the forecast. The projected fall in inflation also reflected the Chancellor's plan not to over-index tobacco and fuel duties. The Committee had taken a mid-point between no indexation of duties and the previous policy. In contrast, the downward influence of sterling's appreciation on inflation was unwinding over the period, while the underlying upward pressures on inflation emerged more visibly towards the end of the forecast period. GDP growth was expected to slow next year, partly reflecting higher interest rates but also slower earnings growth. Annual GDP growth remained between 2.5% and 3% over the forecast horizon, slightly above its long-run average rate.

Mr King commented that there were differences of view within the MPC about the profile of the inflation forecast. This reflected differing views about the extent to which competition would intensify and squeeze profit margins; assumptions about the future path of the exchange rate; and earnings growth. Consequently, individual forecasts differed from the best collective judgement of the MPC, by similar degrees to the August forecast – within a range of one quarter and one half of a percentage point higher or lower than the central projection.

However, the general profile of subdued inflation followed by a pick-up was common to all the MPC. Mr King also noted that publication of the minutes of the October MPC meeting revealed an 8:1 vote in favour of a quarter point rise in interest rates.

Mr King invited Members of Court to comment on the Inflation Report. He said that there were three issues where it would be especially helpful to hear views. First, Mr King noted that output growth had been restrained earlier in the cycle by destocking and weak external demand. That appeared to have ended. More recently, growth in exports had been surprisingly strong and manufacturing output had risen by around 1% in the second quarter of the year. He was interested in views on the export outlook and the recent pattern of stockbuilding. Second, the extent to which retail competition would intensify further was an important consideration for the Committee, along with guidance on the size of the potential effects. Third, Mr King noted the continuing tightening of the labour market in terms of quantities – rising employment and falling unemployment – alongside no clear pick-up in earnings growth. The Committee was interested to hear about current trends and the forthcoming pay round.

In commenting on the markets, Mr Plenderleith said that relatively subdued turnover currently characterised the main bond, foreign exchange and equity markets, with trading settled within current ranges. He said that this reflected a lack of interest in ambitious trading ahead of the year-end and the fact that the main policy positions of the authorities in the key financial centres had been established close to market expectations. He added that there would be a strong incentive for market participants to reduce their position-taking in the new year.

Sir Neville Simms noted the contrast between the weak picture portrayed by construction data and more positive expectations about the outlook for the sector. Output had fallen by 0.5% over the year to mid-1999 but forecasters were projecting a rise of 2% for 1999 as a whole, and 2.7% in 2000. He said this was puzzling given that construction orders had fallen by 9% over the year to third quarter, though he noted that output was typically stronger than orders. Much of the increase in construction output was expected to come from rising repair and maintenance workloads. In response to the issue of earnings pressures, Sir Neville said that the Working Time Directive would add 2.5% to the wage bill within the construction sector. He noted the scarcity of labour in the south-east of England and the resultant large wage increases, and said that the pattern was now migrating to other regions. This was exacerbated by demand for

labour from the Irish Republic. He said there were signs of unrest in the wage bargaining environment but suggested that the wage increases achieved by electricians would not be typical. He added that the West Midlands economy was expected to recover more strongly in 2000 after slowing this year.

Mr Neill commented on the car sector, noting that margins were very low on volume models, but pressures to reduce costs further remained along the supply chain. At the luxury end of the market, the internet was having a significant impact on margins. In relation to stockbuilding, he said that new techniques continued to remove stocks from production and the ultimate aim was to have a 'buy one, make one' system of production and distribution. These techniques were spreading to other sectors and might, in due course, reduce the swings in the inventory cycle. In relation to pay, he expressed concern about the recent Ford wage settlement, specifically that it had been presented as an inflation 'busting' award by both unions and management, rather than related to productivity and performance.

Mr Davies commented on the financial services sector. He said business activity was at high levels, measured in terms of borrowing applications. He said the market was becoming increasingly competitive and that, though profitability was very strong, there were signs that new entrants were attracting business, in some cases with loss-leader products. Consequently the price inertia of consumers was being eroded. In the retail market, mortgage rates were being reduced by new competition. He commented that pay pressures were specific rather than general. This reflected the changing composition of employment in the financial services sector. Branch network restructuring and redundancies were likely to mean low across-the-board settlements. But higher premiums were being paid to particular groups of staff such as IT and internet related staff, call centre and compliance staff.

Mr Stretton noted a shortage of call centre staff in Scotland. He commented on a meeting he had attended in Glasgow at the Bank of England's Agency for Scotland. This had revealed a mixed picture for exports: mechanical engineering remained weak but electronics firms had reported an improvement in activity. Retailers reported that volumes were rising but margins continued to be squeezed. The oil sector was surprisingly flat. The drinks sector was anticipating a strong year-end.

Mr Morris commented on developments in the wage bargaining environment. He said the culture of the pay round had changed, noting that he believed the Ford settlement was the first three-year deal in the car industry. He said this would promote stability and impact on other sectors. He also said that government policies to expand workplace opportunities would further increase pressure in the labour market.

Ms McKechnie said that changes in consumer behaviour were intangible but that there was a growing sense of a paradigm shift in market behaviour. She said this was part of the longer term trend relating to the liberalisation of markets. The UK consumer seemed to be following the US example. She said that a key marker would be the extent to which consumers used the internet for shopping in the run-up to Christmas. Figures on access to the internet were not a good guide to the numbers likely to shop on the internet. She added that price differentials between shops and internet shopping were considerable. She commented that the car market was peculiar in terms of pricing. The structure of supply had disadvantaged individual consumers, who represented between thirty and forty per cent of sales. The response was that a growing number were now looking to purchase cars in continental Europe. Companies were seeking to facilitate this and a new entrant was expected in the new year.

Mr Bailie said that the main issue facing the economy of Northern Ireland was the peace process. The outcome of Harland and Wolff's troubles would have a large impact on the industrial infrastructure of the economy. Discussions were currently underway with a US concern. He noted that there was optimism in the construction sector but prices were under pressure. Information technology was having an increasing impact on costs. Wage costs were only rising in line with productivity growth. Exports appeared to be rising. He said companies had considered their options in terms of prices and volumes following the change in the exchange rate. They had by and large opted to remain in European markets. He said that it was the change in the exchange rate rather than its level which posed problems for businesses.

Mr Hawker commented on the reduction in utility prices. He said this reflected a pass-through of the large gains in productivity achieved in the past and future expected improvements. He noted that there were downward pressures on pay increases in the sector. He added that the Welsh economy, like others, was not enjoying such buoyant conditions as those experienced in

the south-east of England. He said technology was central to economic progress in Wales over the longer term, alongside its European Objective 1 status.

Sir David Cooksey said that problems remained in the clothing sector. He said that there was no sign of wage pressures. He noted that the electronics sector had witnessed a marked fall in orders over the past three months, linked perhaps to Y2K work. The venture capital sector had seen a rapid increase in proposals from internet-related businesses. These investments were very profitable though current gains were unlikely to be sustainable. He contrasted this with life sciences where the long term nature of investment had constrained interest. He also noted that retail property rental values had begun to decline. He suggested that this might reflect the impact of the internet on retail shopping.

Sir Ian Gibson commented on the expectation that stocks would be built-up ahead of the new year by companies anticipating an increase in demand around the Millennium period.

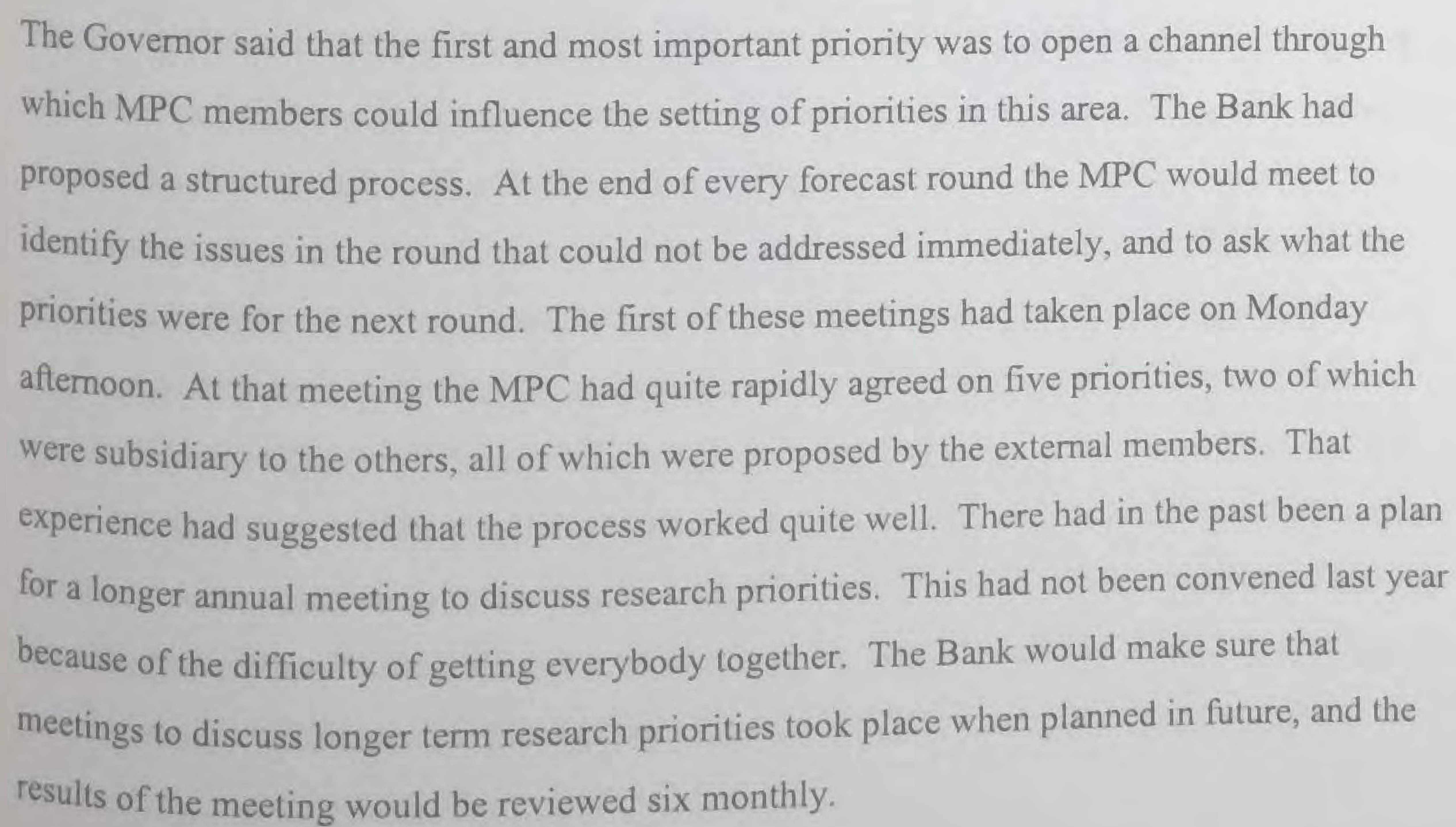
Report by the Governor and Dame Sheila Masters on the issue of MPC resources

Dame Sheila Masters noted that NedCo had met before Court to discuss the issue of MPC resources. The Governor noted that on Monday 15 November the MPC had had a long and fairly detailed discussion, with Dame Sheila, Mr Buxton and Sir David Cooksey in attendance. The issues had crystallised rather well as a result of that discussion. From the perspective of the external MPC members, there was a sense of an uneven playing field in which they were unable to influence work priorities for the collective support of the MPC process as a whole. Another strand of their thinking was that they should be free as a matter of principle to pursue their independent objectives regardless of their influence on the collective resource. There was recognition that there was an overall resource constraint, and the Governor said he believed the external members accepted that. He said he was not talking about the budget but the ability to recruit and retain sufficient people with sufficiently high quality at the more experienced analytical end of the work of Monetary Analysis.

It was clear that it was necessary to try to reconcile these strands. This could be done in two ways. The Bank could seek to satisfy the requirements of the external members by producing

substantial dedicated resources for them. That would be a very difficult process for a number of reasons. They could make the aggregate resource situation worse and the allocation of the resource to individuals, rather than to the collective work, would before very long create a 'them and us' culture. That would destroy the MPC process which was built on nine independent members seeking to input independently to the process. If that view was taken, it was clear that the concerns of every member of the MPC about influencing the resource agenda had to be addressed.

Across much of the resource, this was not a controversial question, because everyone understood that a large part of the analysis was being done to support the process. There was part of the MA resource, the scarcest, devoted to research projects in the context of the forecasting process or longer term work. There was a procedure in place. If a member was unhappy with the attention paid to a project to which he or she attached particular importance, and if it could not be sorted out with Mr King or Mr Vickers, they could talk to the Governor about it, and if he could not sort it out with them he would convene the MPC and the Committee would take a collective view. That process had never been used. There were a number of reasons put forward by the external members to explain why they felt embarrassed to bring the procedure into play.



The Governor said that the first and most important priority was to open a channel through which MPC members could influence the setting of priorities in this area. The Bank had proposed a structured process. At the end of every forecast round the MPC would meet to identify the issues in the round that could not be addressed immediately, and to ask what the priorities were for the next round. The first of these meetings had taken place on Monday afternoon. At that meeting the MPC had quite rapidly agreed on five priorities, two of which were subsidiary to the others, all of which were proposed by the external members. That experience had suggested that the process worked quite well. There had in the past been a plan for a longer annual meeting to discuss research priorities. This had not been convened last year because of the difficulty of getting everybody together. The Bank would make sure that meetings to discuss longer term research priorities took place when planned in future, and the results of the meeting would be reviewed six monthly.

The Governor said there was clearly a trade-off between making that process work and the pressure for independent resources for the MPC members. There was also a broader sense of exclusion among the external members, and he found it difficult to get to the bottom of that. Everybody recognised that the Bank had, in the external members, a resource that everybody wanted to benefit from. There was no intention to exclude them. The contentious part was on the narrower point that, given the constraint on aggregate resources, it was not possible to have nine individuals trying to set day-by-day priorities of individual economists in the Bank. It was necessary to try to unlock this problem. The culture needed to be clarified. Bank staff should have a constructive approach rather than appearing to reject and push away external members. But there also had to be self-restraint on the part of external MPC members. There was a need for understanding. To support that, the Governor believed there was a need to identify where the MPC had agreed on a particular project, agree explicitly what the resource for that was going to be, agree the timetable and - very importantly - agree how to manage it, including the role of the staff on the one hand and of the externals on the other. Approaches differed between one external member and another, from hands-on to the view that input should be conceptual rather than through the management of projects. The role had to be defined at the same time as priorities were established. The Governor said that he believed that could be done, provided there was goodwill on both sides. He believed the MPC was moving towards that.

There was also a need for personal dedicated resources, to avoid MPC members having to do a lot of very minor work themselves such as data queries on factual points. They also wished to conduct a minor research effort that would not be part of the collective programme. On this issue the question was one of scale, given the overall capacity constraint. The proposal the Governor had put to the Committee was that there should be one professional qualified economist per person. At present they had one between four of them. The professionally qualified dedicated people he proposed should be supported by one research assistant in each case. The Governor said that in the context he had described the Bank could find at least some of those resources internally, and internally appointed staff would have the advantage that they knew their way about the Bank. But it was accepted that MPC members should be able to recruit outside if the Bank could not provide the staff, or if that was what they preferred.

Since the meeting on Monday, Professor Goodhart had said that he did not want a dedicated resource because he received all the support he wanted through the existing set up and through

his work at the London School of Economics. If he were to continue as a member of the MPC after his current term ended next summer - which the Governor hoped he would be able to do - and if he did not continue teaching, he would then be in the same position as the others.

If the external members chose to share their personal resources in some way, that was a matter for them. But the Governor said he would want to identify each person with individual MPC members, because if this relatively small resource became a pool it would not be long before the external members were having the same sort of debate as the one taking place now.

A lot of work was required to refine the process and establish the required inclusiveness. Time had to be given for the process to be put in place, elaborated and tested. The Governor drew the attention of Members of Court to a first draft in their folders of a document on the proposed arrangements. He asked Court to endorse the general approach, not the precise language of the text. The text was to be discussed with the MPC on the following Monday and the outcome would then be explained to staff. The document would then be brought back to Court or a sub-group of Court for approval.

Dame Sheila Masters asked for clarification of whether the research assistants would be graduate economists or not. The Governor said that he would like to try to take advantage of recently recruited and quite junior professional economists, who had perhaps been in the Bank a year, though he could not be precise at this stage because he did not know if it was possible to find adequate people. People were needed who met the external members' concerns, and were economically literate as well as having some experience of the Bank. Dame Sheila said that her discussion with the externals had led her to believe that if the second person for each was at graduate level, and not higher, it would be acceptable, but a non-graduate would not be acceptable.

Mr Buxton said he supported the plan laid out by the Governor. The proposal for dedicated resources for each external member, in the context of the Bank maintaining unity, was the right one. He commented that it was very important to maintain the integrity of line management in the Bank - the Governor, Mr King and Mr Vickers - running Monetary Analysis, while at the same time using the talents of MPC members and letting them see what was going on in Monetary Analysis. The Governor said that Mr Buxton had identified the hard part of the

problem extremely well. The Bank proposed that when requirements were determined collectively the MPC would identify the specific resource within MA who would work with one of the MPC people. The role the MPC person would play would have to be identified. It was easier for some than for others to exercise the discretion required.

Sir David Cooksey said he was relieved, because the proposal appeared deliverable. The issue which had come through at the meeting on Monday was a feeling of exclusion by the externals in relation to particular projects. The papers in front of Court addressed that very adequately. The Bank also had a real resource available in the shape of the external members. Sir David said he was concerned to see that there were worries about the possibility that there would be a raid on existing MA resources which were already over-stretched. The Bank should think through the process of acquiring suitable economists. The process of finding the additional dedicated resources would be painful if they were from the existing MA resource.

The Bank should be prepared to shift its ground on the terms and conditions offered in order to raise recruitment levels, if it was going to make resources available as quickly as it could. In the longer term the Bank needed to address the issue of the terms and conditions of external members of the MPC. It was clear that Professor Goodhart did not have some of the problems of the full time members, and it was not easy to see whether the solution should be to have all part time members or some other outcome. This issue should be addressed over the next 12 months. It was important to ensure that the Bank and the Treasury were at one in their view of the ideal process for appointing external members.

Sir Neville Simms said that he was equally relieved to see a sensible framework. He said he would like to reinforce points made by Mr Buxton and Sir David Cooksey. Arguably the language was too conciliatory about the management lines of responsibility. A reminder that HoDs were responsible to their Deputy Governors and Executive Directors would be useful. It would reinforce the point that there should be no undermining of the Deputy Governors who looked after the departments. He also commented that there must be equal access for MA to the research and information created by the externals in their work. That point needed to be worded carefully. The words used in the proposal were positive and inclusive, but it was possible that the Bank would have to help intermediate level managers to apply the framework. He was not referring to training, but thought they might need some help.

The Governor said the key point was the need for clarity. It was not the Bank's culture to be exclusive. He asked Court to endorse the general approach in the proposals he put forward, not the language. The approach would be discussed with the MPC, and once that was done there would be discussions with the staff.

Mr Neill said that the Governor's paper was constructive and helpful and he believed it would be well received by the external members. Problems always arose in a management system when staff were under pressure, and they must understand where they should take their directions from. It should always be through the management line and that should be explained to them.

In response to a question from Dame Sheila Masters, Mr King said one of the constituencies that had not had a chance to express a view on the issues concerned had been the staff of the Bank. Mr King said he had total confidence in all the staff of the Bank. He and Mr Vickers should take the document to HoDs. He noted that MA management was apprehensive. He believed he was speaking for all those involved, including Mr Jenkinson and Mr Vickers. MA had 80 of the best economists in Britain, and the efficiency of the MPC process depended on it being happily managed. The MPC needed them and they needed the MPC. More departures were being seen from MA. There was concern that the inflow was not making up for the outflow.

Another concern was how MA was managed. It was clear that HoDs were in the firing line. They had a very good understanding of the nature of the problem, which was that there were three full time non-executives on the MPC. It was striking that, of the five external members since the MPC began work, three had been unhappy and two had not. Professor Goodhart had joined with the others in the resources discussion, but had not had personal difficulties.
Sir Alan Budd had been extremely happy. Mr King drew attention to a comment by an external member at the meeting on Monday who said that he had no wish to interfere but wanted to know what was going on in order to make helpful suggestions, which Mr King believed illustrated the problem. Since the externals were very much more senior than the staff and HoDs, there was genuine nervousness about how the new proposals would work in practice. It was necessary to convince staff that it would work. The issue was not about a group of

argumentative economists who could not get on. He noted that he had written joint papers with two members of the MPC. The question of full time membership was important. A structural problem was involved. Finding a rewarding position for the externals in the Bank, without interfering in executive management, was difficult. The words proposed would be helpful, but there was nervousness in MA management that they were too close to the status quo. One manager had remarked that he would rather lose an arm to save the patient. Mr King said that he and Mr Vickers would work very hard to make the proposal work. But he would like Court to be aware of why MA was apprehensive because staff felt this was a structural issue that would require structural changes.

Mr King also noted that life for staff had changed with the arrival of the MPC. Before 1997 there was a clear management structure, and staff felt they had time to develop their own work and research, which was leading the world. Since 1997 much of that had come to a halt because of the requirements of the MPC process. There had not been time to do research. Everybody understood in 1997 why there was a temporary halt to research, and staff were promised that after about a year they would be allowed to return to it. The research would be managed by Mr Vickers and Mr King, and would contribute to the intellectual framework of monetary policy. However, it had not been possible to give staff the time to do that. In the second year, the individual demands of external members had eaten up the resources that might have been used to allow staff to make their own contributions. MA had become a very top down organisation in which staff were given things to do. If the job of MA came to be that of a glorified research assistant, the Bank would not be able to recruit and retain staff. Mr Vickers, as Chief Economist, must have the discretion to manage MA so that the really good people could themselves produce ideas that made a contribution to the management of the economy. If they thought they were seen to be there to carry out the pet projects of the MPC, they would not stay. There was not in any sense a lack of willingness to make the proposals work. But Mr King said there were concerns that the approach had not quite got to the heart of the matter. Deep down, successful research was not managed by committees, no matter how many people the Bank recruited.

The Governor said he understood the comment 'we'd rather lose an arm than destroy the patient', but he believed the definition of the patient was somewhat obscure. It would mean setting up a large alternative research department, and that would kill the monetary policy

process, so that patient would be destroyed. He believed it was necessary to find a way to reconcile the interests of both sides. MPC members were very welcome to attend the weekly series of seminars to find out what was going on, but not to interfere with particular projects.

Mr Davies said that some of the characterisation of the problem had tended to suggest that getting things out of Monetary Analysis was like getting blood out of a stone. His experience had been the opposite when in the Bank as Deputy Governor. He did not wish the impression to be left that the organisation was a closed one. It tended to be very responsive. The discussion was about the problems of directing research projects on a major scale rather than finding answers in the short term, and it seemed to him that Court had two things to balance. NEDs had a particular responsibility to ensure that the MPC process was properly resourced. External members had told NEDs that this was the case, but had changed their minds. The other thing was to ensure that the Bank as a whole delivered monetary policy for whoever was on the MPC. So Court had to think about maintaining a good quality monetary resource for all purposes. The solution Court was working towards did reflect an appropriate balance of these two considerations. But in going forward, and developing the words proposed, it was important not to veer too far and threaten the integrity of Monetary Analysis as a whole.

Mr Allsopp, referring to a comment by Mr King, said that it was not just that Professor Goodhart and Sir Alan Budd were part-timers. Both were also experienced policy makers who were at a distance from the machinery and the resource decisions. He was impressed that the monetary policy meetings were unaffected. He also said that he had always worried about nine members signing one forecast, but had been convinced by Mr King and the externals that the process of trying to agree a forecast was extremely productive in a decision making context. MA was extremely open but its reputation in the outside world, while excellent, was that it was a little inward looking. The concentration on excellence could sometimes get in the way. He referred to the checking procedures before work went to the external members. One way of looking at that was as quality control because of the Bank's reputation for excellence, and the other way of looking at it was that it appeared exclusive. Perhaps in thinking about this cultural issue it might be necessary almost to force a more open discussion of alternative approaches. The better the team of economists, the more important it was to look at some of the less convincing approaches to an issue as well, take them seriously but throw them out if necessary, thus widening the debate. The externals wanted to be part of

this well-functioning machine. There were small differences, but he noted that their way of looking at things was feeding into certain paradigm shifts. He believed that it was extraordinarily difficult to set up a relatively open structure that made people feel part of the process.

Mr Morris said that those Members of Court who participated in the discussion in October could not fail to notice how far all the participants had come. He welcomed Mr King's contribution to the debate, and said he had identified the underlying problems, one of which was confusion between executive and non-executive roles. Another was the structure of the function. He believed the structure was reasonably clear in the paper put to Court by the Governor that morning. He noted that Mr King had underlined the importance of ensuring that HoDs and others in MA were not undermined. He was not sure whether the paper set out for the externals precisely what their role should be vis-à-vis the Bank. Maybe that should best emerge out of the MPC meeting the following Monday. Court ought to endorse the broad framework of principles so that at the MPC meeting there would be scope for the externals to feel able to contribute to the ultimate solution. He wanted to carry that spirit forward to the meeting, so that they had a sense of ownership and participation in the final result. He believed the proposal would resolve a short-term problem, but in the longer term everybody would want to keep it under review to see how the relationship was working. What Court must not do was to lose sight of the central objective of being a centre of excellence. No concession could be made to that fundamental point.

The Governor said that he had shown Court a clear indication of the next stage. It would be looked at again in the next day or two and would then go to the MPC, followed by discussions with staff, then back to Court. It was important that Court endorsed the direction and principle of the proposals.

Mr Bailie said that at the last meeting the externals had been looking for 12 economists, and at the time they had one research assistant. Now it was one senior and one junior economist each. He asked whether there was a danger that, having given in on the principle, a long debate would start on the number of people. He noted Mr King's comments. Almost the whole of the problem resulted from the position of full-timers against part-timers. Part-timers had access to

resources through universities and other institutions. He asked whether money might be made available to use for research, rather than people.

The Governor, turning to the issue of full versus part time membership, said he believed Court would not be able to reach a final conclusion on that during the morning, because there were a lot of issues involved. He noted the importance of using the time of the full time external members to advantage but said the process had to be given a chance to function before any further decisions were taken. In any event, the MPC was likely to have three full time members for the time being.

Turning to finance for personal resources, he said that a resource from MA had the great advantage that it would provide a very much more productive interface with MA than giving money and asking externals to recruit outside. It was important that some of the resource came from MA.

Dame Sheila Masters said her understanding was that the external members would prefer resources from the Bank and there was no demand for a budget to manage.

Ms McKechnie said she was very grateful for the maturity and understanding of the management team in the Bank in seeing the need for a short term sacrifice to get a deal that would work for the next few months. The team had moved a considerable distance. Court did understand the management problems. It was concerned that this did not become a major public discussion and debate that might undermine the process and raise all kinds of questions, at a time when the MPC was fairly new. She asked whether it was possible to get a deal before the Treasury Committee meeting the following Tuesday. That was a critical date in the short term. Court recognised that the principal issue was a structural problem. The people who made the original decisions about structure were not people with management experience. If the proposals were seen as interim, then a process was available over the next six months to try to put something together for the longer term.

She said that she did not really understand the difference between interest rate setting and the MPC process, which was seen as something quite different. If Court had a responsibility it was that it must produce a workable process. It should look at what was in the legal framework,

and get some agreement on how the process worked. On a practical issue, she asked whether the answer should be to inject into the system sufficient numbers of people to release more senior staff. Perhaps head-hunters could be employed to get staff in to do the more routine work. 20 or 30 economists on the wage bill was neither here nor there. It was very important that Court had time, at the end of the day, to say what it thought should be discussed over the next six months, and she believed that would go a long way to meeting Mr King's concern that Court was perhaps papering over the cracks.

Mr King said he was not sure numbers were the answer. There were 136 economists in the Bank and 80 in MA, which had recruited 15 but lost a number to outside and to other parts of the Bank. If another 25 economists were recruited there was nothing in the process that would stop the external members absorbing the time of all of them. He would like Court to agree that Mr Vickers, as Chief Economist, should have access to sufficient resources to ensure that Monetary Analysis under him could make a contribution. The addition of a large number of people would ease, but would not prevent, the problem arising in principle. Mr Neill said he supported Mr King.

The Governor said that Ms McKechnie had talked about getting a deal before the Treasury Committee. He said he was asking Court to come to a decision but not with the intention of "getting a deal", because frankly he did not think Court would necessarily get the outside members cheering in support of the arrangements proposed. What was needed was Court's endorsement, because if a public debate arose then the Bank had to be prepared to defend the decision. The Governor said he did not think it was possible to rely on a deal, in the sense that everybody agreed on it before the Treasury Committee, or indeed after.

Dame Sheila Masters said that NedCo believed that whatever the outcome it should be acceptable to all members of the MPC. If resources of two people each were offered, it was going to be acceptable, but it was not what they really wanted, and the issue also remained of whether the concordat was acceptable to those who bore the brunt of it, in MA. The NedCo position was that the Committee wanted something capable of agreement by all parties.

The Governor commented that members of the MPC would be at the Treasury Committee on Tuesday morning, and it was unlikely that all would put up their hands and say they had signed

a concordat. Some of the externals might be more emphatic in their views on their ability to do what they wanted to do, and their need for larger resources. That had to be recognised, and it was also necessary to recognise that it was highly likely to come out in public.

The Governor said that, while on that point, he was extremely disappointed that a Member of Court was quoted in a newspaper. He deeply regretted that. The Financial Times would be contacting all Members of Court during the afternoon to ask what had happened during the meeting. He hoped Members of Court would take the position that they never commented on Court decisions. Members of Court agreed.

Mr Hawker said the proposals were a sensible way forward and Court should recommend that they were discussed with the MPC as the view of Court. Court should also signal to staff that there would be a review after a period of time. Court also had an obligation, if it thought there was a structural problem, to undertake to review that in due course too.

Mr Stretton said that the situation was similar to that in a large financial institution with centralised computing, where there were competing customers in the organisation for its services, and some parts of the organisation would like to do their own things separately. There was in such cases a strong reason for keeping a degree of central control. One lesson from such structures was that it was usual to allocate resources centrally to local business areas, because they may have priorities and needs that might not rise to the top. But it was necessary to be careful about what subjects local business areas could tackle, or their demands would increase. It may be necessary to do more work to define what work the external MPC members could tackle with their local resources.

Mrs Heaton, referring to Mr King's comments on full-time non-executive members of the MPC, said that they did not begin to qualify as full-time NEDs in the corporate sense. They were not generalists but experts, and they required continuing resources to further their expertise. They were not external - a word she found excluding, and would prefer to avoid - but were Chancellor-appointed. She noted the importance of capitalising on the availability of these people. Expressing that sentiment to the externals would help bring them towards a constructive way forward.

Mr Buxton said the Governor had put a sensible plan, and Court should back the management. The outline of what the Governor had put on the table should be supported by NedCo, whatever the externals said. The Governor agreed.

Mr Allsopp said that he was reluctant to lose a deal for the sake of the number involved. If there was a further discussion on the numbers he would not mind giving the Governor discretion to negotiate. The Governor replied that he did not want such discretion. This was not just a question of quantum but one of principle. He sought Court's decision on a specific proposal.

Mr Allsopp said that another contentious aspect was personal resources set against group resources for the executive. A point he expected to be made was that the original proposal by the externals would allow a variety of specialists to be included. The Governor said that if they wanted different types of people that was something the Bank could take into account.

Dame Sheila Masters said she believed this was a proposal that the external members would be prepared to make work. It might not be the best solution ever, but it would be acceptable and would not provoke another major dispute in the short term.

Mr Morris said he understood the Governor's views about agreeing a specific proposal. The principle was an important point. Court should not, however, get into the business of allocating resources in the Bank in a micro way. A proposal had been produced, and he was happy to endorse it. He did not want the external members to think that all they had to do was to come to Court and ask for a number of people. He believed it was for the Governor and the management to talk to them. Court should distinguish between the numbers and the principle, and that was the best way.

The Governor said the principle had to be translated into practice. The debate at one level was about the way the externals wanted more resources to pursue their agendas. Court was considering a proposal of one senior and one junior resource, as a reasonable response to the situation. Mr Morris said he was happy with that. If the Governor decided it should be marginally different he would also be happy.

Mr Davies said that Court should agree that what the Governor was proposing was reasonable. He did not think it had to be acceptable to the externals. The Governor's job was to try and make them happier about it. He, Mr Davies, would be tougher on the staff issue. It was necessary to be clear when recruiting for the new positions that they were clearly specified and that the specifications did not change, which would lead to a problem for the Bank. The Governor agreed.

The Governor said he was grateful for the support of Court. He hoped the issue would not surface again in public. If it did, the Bank would have to defend the proposition discussed at Court. He was quite happy to defend the proposition.

Dame Sheila Masters asked whether Court could be kept informed of the progress of the discussions with the externals. Sir Neville Simms proposed that this should be done through Dame Sheila. The Governor agreed. He said it would be discussed with Dame Sheila, and the Bank would send non-executive Directors the document as it progressed, and try to keep them in touch with how the discussions were going. He hoped the document would be agreed by the MPC and then put again to Court in December and be endorsed by Court.

Court agreed to the principles contained in the draft document before it, which set out guidelines for the relationship between external MPC members and the Bank. Court decided that an additional resource should be offered to each external MPC member of one senior economist and one research assistant.

Sheila V Masters
15.xii.99

Peter [signature]
15.12.99.

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 DECEMBER 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 Allsopp

Mr Bailie

Mr Buxton

Sir David Cooksey

Mr Davies

Mrs Heaton

Sir Chips Keswick

Mr Morris

Mr Neill

Sir Neville Simms

Mr Stretton

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

MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Vickers, Plenderleith and Clark together with Dr Julius in attendance)

Before inviting Mr Vickers 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 22 December.

Mr Vickers, in introducing the discussion, noted that the international economic environment remained generally positive. He said the US economy continued to power ahead without any marked signs of rising inflation, at least in non-asset prices. Output growth was robust and

November's US retail sales data showed a continued strong picture. Unemployment was still falling (4.1% in October) and earnings growth remained fairly benign. Unit labour costs were particularly favourable. Consumer prices inflation was steady at 2.6% with the core inflation measure a little lower. Turning to Japan, the picture there remained mixed and uncertain. He said that it would be wrong to focus too much on the 1% fall in GDP in the third quarter – it was accompanied by an upward revision to the second quarter estimate. But it was still unclear whether or not Japanese growth was self-sustaining and the latest Tankan survey was not as positive as had been expected. European economies continued to display diversity. He said there were some signs that the official data were catching-up with the improvements recorded earlier in surveys. Growth in the third quarter had been around 1% and unemployment had dipped below 10%. In addition, recent orders data from Germany showed an improvement, alongside a further rise in business and consumer confidence. Forecasts of EU growth were generally being revised upwards.

On the domestic front, the ONS had confirmed their first estimate of GDP in the third quarter, still 0.9% and 1.8% higher than a year earlier. Manufacturing output had increased at a faster rate than services output. The composition of demand had been similar to that expected. The drag on growth from net trade and inventories had ceased and consumption growth had remained fairly strong. But the distortions to the pattern of spending on vehicles remained following the registration date changes. This made a reading of the strength of consumer spending difficult but the underlying picture appeared to be reasonably robust. Business investment was weaker than expected. There was, of course, a possibility that the figures would be revised upwards but it was also possible that spending had paused following Y2K related spending. This was obviously difficult to gauge. Survey indicators pointed to a continued economic recovery. Mr Vickers added that the National Institute's monthly GDP measure estimated growth of 0.8% in the three months to November.

Over the next few months, it was likely that there would be additional difficulty interpreting developments due to Millennium distortions. This might already be an issue in the narrow money data: M0 grew by 8.7% in the year to November, perhaps reflecting an increase in precautionary money holdings. Discussing money more generally, Mr Vickers said household borrowing remained robust, both secured and unsecured. House price measures had differed over the latest month, but the situation remained much as before. Sterling had remained strong over the latest period, as had equity markets globally.

The labour market still exhibited growth in quantities, though less strongly than previously: the LFS data showed that employment had risen by 66,000 over August-October; unemployment had fallen by 12,000 though average hours worked had declined. The claimant count measure

of unemployment had fallen 10,600 to a rate of 4.1%. Contradicting the LFS data, the workforce jobs data revealed a fall in employment of 48,000 in September, though Mr Vickers noted that the series tended to be volatile and less reliable than the LFS data. On the earnings front, the strength was mainly in private sector services. Bonuses were having some effect though the data still needed to settle down after changes to the Average Earnings Index. The key issue going forward was the next pay round. The Bank's Agents had started to register concerns and Mr Vickers invited Court to comment.

Annual RPIX inflation was unchanged in November at 2.2%. The contrast between low goods and high services prices inflation remained evident. Within goods, food price inflation had increased but this had been offset by further falls in car prices, possibly reflecting the effects of the competition inquiry, which might be delaying purchases. Annual inflation on the RPI and RPIY measures increased to 1.4% and 1.7% respectively. On the cost side, Mr Vickers said that annual input price inflation was now over 9%, largely reflecting higher oil prices. Annual output price inflation was 2.1%. A theme at present was the rise in cost pressures without any clear price pressures evident.

In commenting on the markets, Mr Plenderleith said that movements in exchange rates leading up to the year-end period might be puzzling. The strength of the yen was a current conundrum. It could be rationalised in terms of the recovery in Japan, but that remains fragile and could be undermined by the yen's appreciation. The parallel weakness of the euro might reflect short-term factors, notably defensive positioning in favour of the dollar at the year-end; cyclical effects, insofar as there was uncertainty about the pace of recovery in the euroland economies; or perhaps structural factors in the form of fewer reforms than had been expected. But the weakness of the euro was odd alongside the rise in equities. As for the policy implications, the ECB had stated it was not focusing unduly on the exchange rate, but that was itself impacting on market confidence in the euro. The strength of sterling increased the discomfort for UK policy. As current rates did not generally equate with equilibrium views of sterling's value, he said that we might see increased volatility in the new year.

Sir Chips Keswick mentioned that he was aware of some opinion in North America which suggested that black market cash, including IMF Russian funds, was flooding into the equity market. Mrs Heaton inquired whether or not the Bank had undertaken an analysis of the equity market which stripped out the 'dot.com' effect.

Mr Clark said work was underway though not complete. The Governor added that the rise in equities was broader than 'dot.com' itself, and included telecommunications and technology-based companies more generally – sectors which were growing strongly. He mentioned the

discussion at the G7 meeting on whether the strength of the equity markets was more or less vulnerable to collapse given what was driving it. He noted that the US viewed this more comfortably than had been the case on previous occasions. Mrs Heaton said it was not possible to fully understand current developments but it was certainly a sizeable phenomenon. Mr Allsopp said current market conditions were similar to those seen in the 1980s. Short-term flows were an important factor and he asked whether current exchange rates could be explained by expectations about future interest rate increases. Europe had already increased rates with less expectation of a further rise. Mr Plenderleith responded by suggesting that he thought exchange rates were being driven by expectations of growth which currently favoured the dollar. If this was viewed as likely to result in overheating, interest rates may rise. But if it was thought that continued growth would be non-inflationary, the interest rate implications were different.

Sir David Cooksey suggested that the 'dot.com' sector was presently in favour but the market would no doubt take its revenge if earnings expectations were not realised in due course. He said private rather than institutional investors were behind the gains. This had created unusual liquidity in small stocks but this would be temporary. He urged caution rather than comfort in this area.

Mr Neill referred to the car market. He said registrations were very distorted and it would be difficult to call for some months. Around 2.2 million cars had been registered in 1999 which was more than had been expected. But the pressure on suppliers to reduce costs had intensified this year. Some manufacturers were seeking 10-15% reductions on an annual basis. The 'cost-down' psychology was now also becoming evident in other sectors, notably the rail industry. But he felt this mentality was on a collision course with wage increases of 4-5%. The Governor said the car market was adding to the fog. Mr Morris mentioned the inquiry into car prices and the extent to which this was delaying sales and diverting business to Europe. Mr Neill said parallel imports were overall fairly trivial. He was concerned that prices would not fall by as much as consumers were perhaps expecting. Dr Julius asked Mr Neill to speculate about the dynamics and consequences of continued cost reduction in the car industry in terms of the next stage of this process - would companies respond by increasing productivity and greater investment in capital? He responded by agreeing that productivity efforts would be intensified and drew a comparison with the appreciation of the yen and the response of Japanese manufacturers in the mid-1990s. They had reduced costs and sought improvements in product design. But he felt that the US and European response was more likely to focus on merger and acquisitions resulting in a consolidation of the component supply base. In time, manufacturers would want to expand the supplier base if a few key groups started to dominate.

FINANCIAL STABILITY ISSUES
(Messrs Clark, Plenderleith and Vickers in attendance)

In bringing Court up to date with developments, Mr Clark noted that the Bank had published the latest edition of the Financial Stability Review at the end of November. There had only been limited press coverage but there had been positive feedback on the publication more generally. The Review was still at an experimental stage in terms of the balance between content and depth of analysis, but good progress was being made. Mr Clark also drew Court's attention to the latest and final issue of the Y2K Blue Book. This issue set out in detail arrangements for the end-year period. The Bank would be working closely with the FSA over the period. On Y2K concerns more generally, he said sentiment had calmed over the past few months. The money market 'spike' had declined and there had been an expansion rather than contraction in equity market trading volumes, to around two billion shares per day recently compared with an average of around 1.2 billion per day in October. Much of this growth was driven by retail investors.

Developments in trading and settlement system were centred on two events: the tie-up between Sicoram and Euroclear; and the decision by the Deutsche Borse to sell shares to international broker-dealers, which was effectively a demutualisation. In relation to emerging markets, Mr Clark said there continued to be a modest improvement in conditions: borrowing spreads had declined and equity markets were rising. However, within the general picture there was a greater degree of divergence in emerging market performance and greater differentiation with regard to risks on the part of investors than was previously the case.

Sir Chips Keswick commented that the Financial Stability Review was an excellent publication. He expressed confidence that the Bank had a good team and was well equipped to handle the next crisis, whenever it may arise.

FINANCIAL MARKETS OPERATIONS ISSUES
(Messrs Plenderleith, Vickers and Clark in attendance)

Mr Plenderleith drew Court's attention to three issues. First, he said efforts continued to ensure markets underwent a smooth transition over the year-end period. Sentiment was encouragingly calm but it was important not to be complacent. The Bank was continuing to monitor developments carefully. The money market 'spikes' had subsided, accompanied by a general feeling that the markets would have adequate liquidity over the period. A further indication was that we had seen much less decline in activity than expected: the equity market had continued to rise; there had been significant movements in rates in the foreign exchange markets; and

there had been a sustained high level of bond issues. In other words, profitable opportunities were still being pursued. He added that the Bank would remain vigilant.

Second, referring to the gold market, Mr Plenderleith said tensions had subsided. The third Bank of England auction had taken place on 29 November. The offer had been covered two times and had achieved a price of $293.50. Since the UK auction, the Dutch authorities had announced a programme of sales to be channelled through the Bank for International Settlements rather than the use of open market auctions. There had been some movement in the market, though the Dutch sales were within the announced European limit: initial sales in the Dutch programme had been at worse prices than the Bank's November auction.

Third, Mr Plenderleith mentioned the Bank's involvement in a BIS credit facility for Brazil arranged a year ago. This was a $15bn accompaniment to the IMF stabilisation package. Brazil had drawn on the facility twice. The Bank of England's participation totalled around $400mn in each drawing. As this was covered by a Treasury indemnity, there was no risk to the Bank arising from this arrangement other than an operational risk. The Bank's share in interest payments by Brazil on the facility would amount to close to $1mn.

Mrs Heaton asked about the programme to manage debt maturities over the new year period. Mr Plenderleith said the practical arrangements were all sensible and were aimed at ensuring the market did not dry-up over the period.

In relation to the Brazilian facility, Mr Buxton asked if there were any balance sheet effects from the guaranteed liability. Mr Plenderleith replied that he would check that the operation was not on the balance sheet, but there might be a contingent liability. Mr Buxton asked the Bank to consider, whether in that event, the contingent liability could now be decreased. [It was subsequently established that there was no contingent liability].

EXECUTIVE REPORT
(Messrs Clark, Plenderleith and Vickers in attendance – Mr Footman attended only for the Benefits item)

NMB

Mr Clementi informed Court that heads of agreement had been signed with Nikko for the sale of NMB for approximately £30 million, against a book value of £26 million, which would give a small write back. Nikko was doing due diligence. It was hoped to exchange contracts in

January. Mrs Heaton and Mr Buxton agreed that it was excellent news. The Governor said that Nikko had been made aware of adverse articles which had appeared in the press.

External Audit

Mr Clementi proposed that the Bank's external audit should be put out to tender, which he noted was a matter reserved to Court. It was intended to hold the competition after the current year's Report and Accounts, and the exercise would be led by himself with support from the Audit Committee. PricewaterhouseCoopers had confirmed they would re-tender. It was hoped to bring a final proposal to the July Court.

Benefits

Mr Clementi noted that Court had encouraged the Bank to introduce a new package of benefits. The Bank was determined to move to a new system; there were serious flaws in our current systems which were inequitable and inefficient: but a number of staff were against change, and certain elements in the Bank saw the proposals as an opportunity to stop progress within the organisation. He said that those in charge of the management of the changeover had come under considerable personal pressure and some very regrettable personal abuse.

Mr Footman noted the very strong reaction to the proposals, which he believed was not entirely surprising, because the benefits structure had been embedded in the culture of the organisation. The union was willing to negotiate new arrangements, but not for existing staff, so that the change would take forty years to mature. There had been five meetings, and the union's intention appeared to be to obtain a rejection of the proposals at a ballot in January. Members had been advised by the union to do nothing. The union appeared to expect that the Bank would give in. After further explaining his paper, Mr Footman said that he was more than ever convinced that it was right to press on, but it was clear that there would be a core of strong opposition right to the end. So it would be helpful to continue in the knowledge that the Bank had the full backing of Court for the proposals.

Mr Davies said that if it was any encouragement, he knew from his own experience that there could be light at the end of the tunnel. Having introduced something rather similar at the start of the Financial Services Authority, a survey of staff eighteen months later - which included the issue of benefits - had shown overall results of a very positive nature, and they were also

positive in the areas where former Bank people worked. Enthusiasm among the latter was not conspicuously any less. When they got used to such arrangements people did like them. Furthermore, staff had not duplicated what they had had in the past. Only one among fifteen hundred had attempted to duplicate the previous benefit package. The implication was that there was a lot of waste in the old system, so the change had led to a welfare gain. A difficulty was if one became embedded in arguments about the individual parts of the package. It was important to keep arguing that, looked at in the round, the package was fair. He commented that the Bank was offering a good and balanced package.

Mr Buxton recalled from previous Court meetings that his opinion and the opinion of others had been that the existing Bank package had been so out of line with the market and was so extraordinary that it should have been tackled years ago. He fully supported what Mr Footman was doing. The Bank should also have a more flexible salary scheme and be prepared to pay more. He hoped that the costs of some of the extraordinary benefits offered by the Bank would go down, and the savings could be translated into salary in parts of the Bank where there were shortages of staff. Mr Neill said that he had also been convinced at earlier meetings that what the Bank was doing, in the round, was perfectly reasonable. During implementation of such packages, arguments were sometimes heard that particular points had not been thought about, and some adjustments might be appropriate, but that was all. Bank staff were very fortunate because they were cushioned from what was happening to people in the private sector. He argued strongly against buckling under pressure of opposition to the proposals. The Bank should be absolutely resolute and clear that this was what it was going to do.

Mr Stretton agreed. He noted Mr Footman's comments at the end of his paper about a significant group of people in the Bank disappointed in their careers and locked in by their benefits, but commented that he saw that as a separate problem. Mr Clementi said that he agreed with Mr Footman's last sentence, as noted by Mr Stretton. It was plain that there were a number - not a huge number - of people who could not afford to leave the Bank because they were paid substantially more than in the private sector. The Bank had also allowed them to become over-geared. That was something that the Bank had to work out. The new benefits package was part of that.

Mr Plenderleith said he was troubled by any sense in Court that staff were feather bedded, cushioned by benefits and protected from the real world. This was the opposite of the truth. The Bank was not trying to change the totality of benefits, but the way they were being delivered, to make them more relevant to the future. He would not like to leave the impression that the generality of staff were not performing and delivering, for remuneration that was substantially less than they could have outside in the market. With housing loans, the most sensitive area, it was quite right that the Bank should aim for the future, but it did create for some people a transitional problem. In the past the Bank had relied on two forms of remuneration package - salaries less than market rates, combined with cheap loans, which were part of the package. This was what people were offered, and they had been encouraged to draw a capital sum higher than would have been sensible if at a market interest rate. So it had to be acknowledged that there was a transitional problem.

The Governor agreed with Mr Neill's point about how it was necessary to listen to complaints and where necessary to make adjustments in the balance of losers and gainers, and he said that was very much in hand. In answer to a question from Mr Morris, Mr Footman said the aim was to implement the proposals on 1 April to tie into the tax year. The union was likely to want a ballot in January. If the package was to be enhanced, that decision would have to be made clear to staff by then. Beyond that, the Bank would consider its position after the outcome of the ballot was known. It would be a matter of looking at contracts and making proposals to staff. Some would accept and some would not accept.

Mr Morris commented that this process would roll into the salary review which started in January, so the two would come together. Dame Sheila Masters asked whether the proposals could be imposed, if they were rejected in a ballot. Mr Footman said the Bank could offer new contracts. Technically, it had given notice that it had a reasonable business case for wanting to change the benefits structure. In January it could write to staff and say it proposed to continue with Benefitselect, and offer new contracts. However, the Bank would prefer not to take the issue to the wire. It was also a matter of hearts and minds. But that advice about contracts underpinned the Bank's approach, and the unions were aware of that.

Court gave full consent to the Bank's approach to the benefits review.

MANAGEMENT OF THE BANK

Other

IT strategy in the Bank
(Messrs Clark, Plenderleith, Vickers, Midgley, Mann and Jenkinson in attendance)

In describing his paper for Court, Mr Mann said that the overall approach was to ask users their business requirements, and this drove the strategy, rather than technology issues.

Mr Buxton said that the relationship between the centre and the divisions was the key one in the management of IT. It was essential to have a central function which kept control of the architecture and the interaction between different divisions. There should not be too much independence in the divisions. He was not sure from Mr Mann's report that the relationship was as it ought to be. The central function needed to be very strong. It had to encourage divisions to take their own initiatives within parameters laid down by the centre. He noted comments by Mr Midgley in the Audit Committee on the lack of written down knowledge in the Bank on IT matters, which was kept instead in people's heads, which created some dangers for the future. The Audit Committee had also raised the issue of whether there were too many systems in which change was started but not driven through, which increased the risks. Finally, he noted that new IT systems had to interconnect with changes in business processes.

Dame Sheila Masters noted two issues: one was how the centre ensured collective working and sharing of information; the other was whether the role of the centre was to evangelise for technology within the organisation. Technology was moving very much faster than individual business areas could keep up, and the role for the centre was to help the organisation be at the frontier of technology. Mr Clementi agreed with Dame Sheila. Mr Neill said that his company had created a permanent IT showroom which had had a sensational effect in allowing people to discover what was possible. It was important to have some part of IT investment devoted to facilitating understanding. He also noted that his company was working in the area of knowledge management, and he pointed out that many companies were contracting out the management of desktop computing and telecoms. He had not seen facilities management mentioned in Mr Mann's report. He would like to see the Bank coming to a view on whether that was appropriate for the future or not.

Mrs Heaton said it was called a strategy paper but there were words in it that made her wonder how far the Bank had progressed. For example, every IT activity needed an owner and she was not sure all of them had. She also believed that the aims in Appendix 1 were quite loose and she would like to see more concrete proposals of what was going to be done, by when, and by whom. Mr Stretton said the structure seemed sound and it seemed inevitable that management was applied to subsets of the problem. The difficulty was how to assess the quantum of resource required. How was this done?

In reply to Mr Buxton, Mr Mann said that there were changes all the time in the relationship between the centre and local areas. Movement had been towards more centralisation and standardisation. Such changes were managed through ManCo. Replying to Mr Buxton's second point, Mr Midgley said the lack of written down knowledge was an issue that was beginning to be recognised internally. He was not sure the Bank had a solution. The first step was to recognise the potential problem.

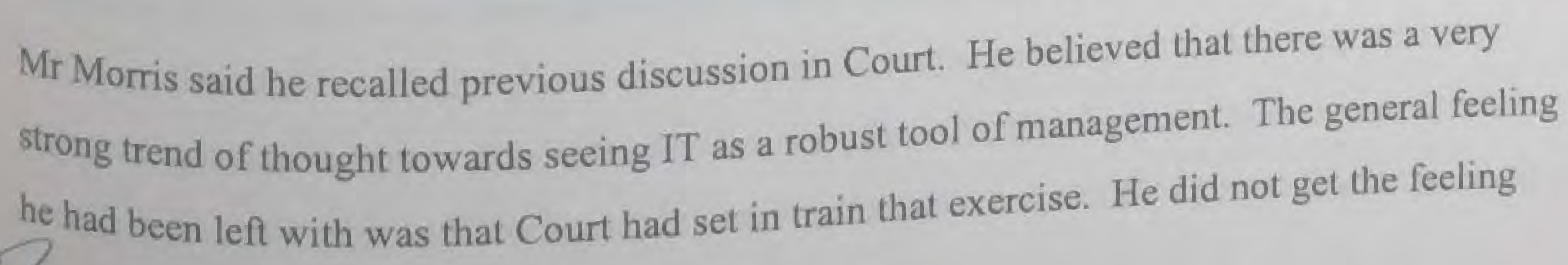
Mr Mann, replying to Mr Buxton's third point, about systems not necessarily linking to business processes in a coherent way, said there was work in Monetary Analysis employing outside consultants and, in banking, a business process review was underway. Both of these initiatives were looking at changes in the use of IT to support changes in the business prcess, in a coherent way. Mr Buxton said he took that as an indication that the centre was not strong enough in the process. Mr Mann said that his area were IT specialists not bankers and economists, and it was not possible for them to dictate business processes to economists and bankers. It was necessary to advise but not impose. In reply to Dame Sheila's points, he said that the centre ensured collective action happened through ManCo. He took issue with the suggestion that the Bank needed to be at the frontier of technology in all cases. It was not clear whether all parts of the Bank needed to be. Some did, for example the markets area. For others, being at the frontier could be a very dangerous matter. It was sometimes referred to as the bleeding edge, rather than the leading edge, because it could be expensive and risky. The decisions came from the business areas, whose needs differed so there could not be a Bank-wide policy. On the issue of evangelising for technology, coming as he did from a technical area he felt that was a bad thing. It was necessary to have an economist or a banker as an evangelist for IT in economics and in banking, as they would have the keenest sense of what IT

could offer. In most business areas there were people capable of playing that role, and they were encouraged to do that. Mr Midgley said he would prefer three IT missionaries in the business jungle to 10 at the centre.

The Governor said he was sure Mr Midgley would accept that the role of the centre was to make business areas aware of changing technologies and availabilities. Mr Midgley said the centre could not dictate to the managers of business areas who were the only people who could put a value on the opportunities for their businesses. In reply to a question from the Governor about knowledge management and outsourcing, Mr Mann said that the aim was to find better ways of using new technology. For example the Bank was looking at electronic document management which would operate across the Bank, and was looking at IT projects to improve workflow in personnel and accounting. An intranet had been created which was the foundation of many of the proposals for future developments. Turning to outsourcing of desktop computing and telecoms, he said there had been a conscious decision not to take this route. The main drivers were that it was not necessarily cheaper and the Bank did have a problem with security. The people who managed the IT platform had access to all the Bank's information. However, the current answer was not necessarily right for all times, and should be reviewed from time to time. There would be no harm in another look. The team involved was not huge and he was not sure that there would be particular efficiency gains.

Dame Sheila noted that the last review of IT had been in 1992, which in technical terms was generations ago. She asked whether it would be a good idea for the Bank to review IT strategy sometime in 2000. The Governor agreed that it would be a good idea. It would be considered, and the Bank would come back with a suggestion for Court later on.

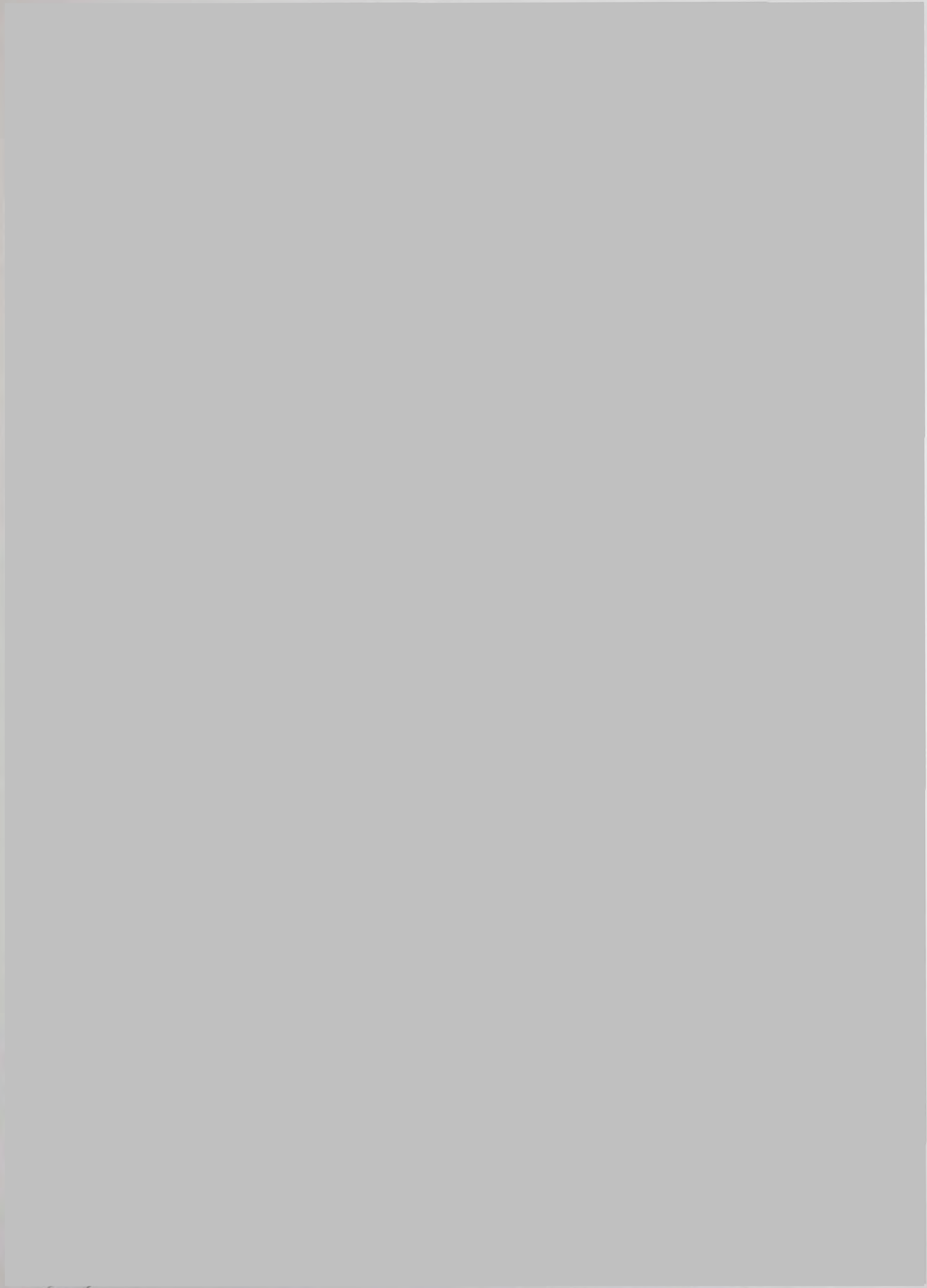
In response to a question from Sir David Cooksey, the Governor said that the issue of the strongest possible firewalls to ensure security had been a major issue in IT for years. The Bank had finally been persuaded that security could be effectively delivered electronically rather than with air gaps. The outcome of that debate could be reported to Court.



Mr Morris said he recalled previous discussion in Court. He believed that there was a very strong trend of thought towards seeing IT as a robust tool of management. The general feeling he had been left with was that Court had set in train that exercise. He did not get the feeling

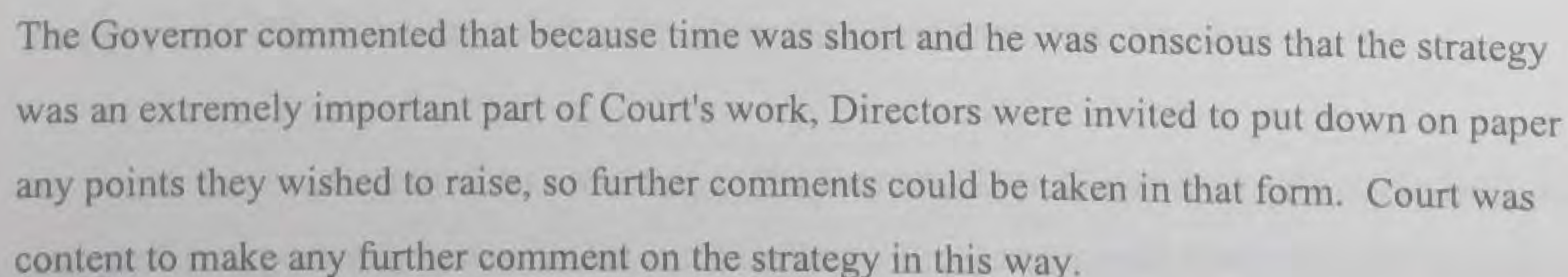
that the Bank had grasped that nettle. What came across was that the centre was a facilitator. There had to be very clear information about what the centre wanted IT to deliver.

The Governor, noting Mr Buxton's and Mr Morris' remarks, said the discussion had perhaps shown insufficient sensitivity to the very different natures of the different activities in the Bank, which was quite a different organisation from a commercial bank. It was necessary to adapt approaches to different areas. To drive IT from the centre would be a disaster. However, the Bank needed to justify that proposition more strongly than in the presentation Court had just heard. Because of pressure of time he would like to adjourn the discussion of IT, and not go on to the discussion of IT in Monetary Analysis. Court would come back to that at a later stage. Mr Vickers said that nevertheless he would like to push on with what was proposed in Mr Jenkinson's paper on IT in Monetary Analysis. Dame Sheila said that in broad terms Court would like to support him, but discuss it in detail later. The Governor noted that Mr Vickers had a green light.



Turning to the broader Bank strategy, Mr Clementi said that the paper before Court was from the Senior Staff Conference, with input from senior management. He would be surprised if there were any great surprises. There was no real change from the route set out two years ago. Sir David Cooksey asked whether there was a danger of too much overlap between the Bank and the Financial Services Authority in the Financial Stability area, and whether their interface was managed enough. Mr Davies said that if the Financial Stability area as a whole was looked at, the issue of overlap did not really arise in domestic finance or very much in market infrastructure. There were three areas where it did arise: financial institutions, international finance and regulatory policy. He believed that the financial institutions work fed quite well into what the FSA did. Since the FSA started, it had built up its international financial area more, but it had done that for supervision purposes and was not looking at the development of the economies concerned for their own sake. But he believed it was necessary to be careful about overlaps in that area. Turning to regulatory policy, the fact that the Bank and the FSA were on the Basle Committee was not controversial. There was always a need to ensure that the teams were working in areas where they had comparative advantage, and that the Bank team was working on big macro financial stability issues and not getting too embedded in the details of interest risk models and the way banks sort out operational risk. He said that, frankly, from time to time the teams did overlap, particularly where they were on the same committee. The Governor agreed, and said it was more so in that area than in international work. The Bank had an involvement in the international policy debate which was distinct, for example the G7 and the IMF, and it needed support for that sort of purpose, for example in analysing the Brazilian IMF programme. The FSA had a similar need, but from the individual institutional point of view. The justification for that distinction was quite strong and it was also encouraging that, since supervision had gone to the FSA, that relationship had fallen into place naturally. Furthermore, in recent periods, an international division with an emerging markets focus had been very important in monetary policy discussions. He concluded that any overlap was not so much on the international side as on the regulatory side.

The Governor commented that because time was short and he was conscious that the strategy was an extremely important part of Court's work, Directors were invited to put down on paper any points they wished to raise, so further comments could be taken in that form. Court was content to make any further comment on the strategy in this way.



Report from the Chairman of the Audit Committee

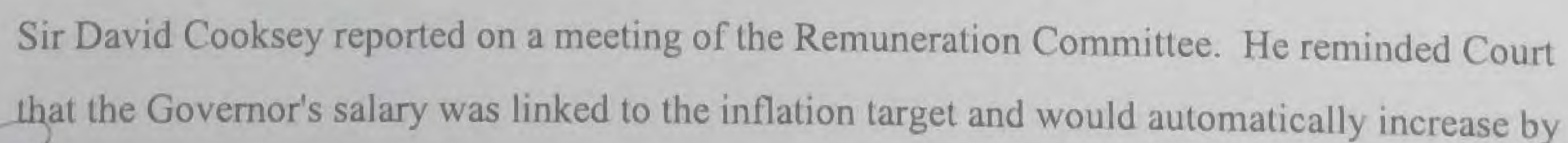
Mr Buxton presented the Audit Committee report to Court. He noted the discussion of the function of the Middle Office and also the Audit Committee's view that the risk matrix was too complicated, with a huge amount of detail. He suggested something rather less complicated should be brought to Court. He noted the Audit Committee discussions about IT issues, which had been touched on earlier in Court, and also the beauty parade for new auditors. The Audit Committee believed that the competition would be focused more on good practice than the fee.

Guidelines for the use of MPC resources

The Governor drew Court's attention to the guidelines for the use of MPC resources which had been presented to Court the previous month. These had now been agreed in detail with the MPC and promulgated to members of staff. He invited Court to take note of the guidelines. Any comments would be welcome. Mr Morris asked whether, given Treasury Committee comments, there was value in publishing the guidelines. The Governor said that the danger was that if it were ever necessary to change them they would have to be updated publicly. Essentially it was an internal management issue that should never have got into the public domain, as the Treasury Committee said. He would be very reluctant to publish internal guidelines of this kind.

Recommendations from the Chairman of the Remuneration Committee

In accordance with Schedule 1, paragraph 13 (5) of the Bank of England Act 1998, the Governor and the two Deputy Governors absented themselves and in accordance with paragraph 13 (3) of the above Schedule, Dame Sheila Masters took the chair.



Sir David Cooksey reported on a meeting of the Remuneration Committee. He reminded Court that the Governor's salary was linked to the inflation target and would automatically increase by

2.5%. He noted that the Governor came to the Remuneration Committee meeting with recommendations which the Committee had accepted, with some complications. The Committee had agreed to recommend:

(i) a 2.5% salary increase for the two Deputy Governors, the Executive Directors, the external MPC members and Sir Peter Petrie,

(ii) in addition, an increase of £10,000 in pensionable salary to both Mr Clark and Mr Vickers,

(iv) that the above increases should come into effect from 1 January 2000.

The qualification was that the Committee agreed that Benefitselect should apply to Executive Directors but not to Governors, Advisers or external members of the MPC. Sir David noted that Benefitselect would give the ability to secure a larger increase in pay by giving up other benefits and that could cause problems externally. This point was accepted by the Deputy Governors and others involved. It was also noted that a paper on the question of bonuses for Governors and Executive Directors would be brought to Remuneration Committee in January or February.

Court noted and APPROVED the recommendations.

Court was up.

19.1.2000

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