12A110/25

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A COURT OF DIRECTORS HELD IN EDINBURGH AT THE OFFICES OF STANDARD LIFE ASSURANCE CO.

WEDNESDAY 19 JANUARY 2000

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

Mrs Heaton

Sir Chips Keswick

Ms McKechnie

Mr Morris

Mr Neill

Ms Kathleen O'Donovan

Sir Neville Simms

Mr Stretton

The Minutes of the Court of 15 December 1999, having been circulated, were approved.

MONETARY STABILITY ISSUES

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

Mr Vickers noted the 0.25% interest rate increase to 5.75% earlier in the month, and the reasons given for it. He said world growth was likely to be stronger in 1999 than expected and the output for 2000 was robust. The US economy steamed ahead with little sign of inflationary pressures and euro area demand continued to look encouraging. The euro was looking quite weak again while stock markets around the world had risen since the last Court meeting despite the large falls in the New Year. He noted the strong growth of narrow money in December. Sterling had remained strong. There was not much news on demand and output, though he noted revisions to GDP growth and said there was a question over whether the investment slowdown had a temporary Millennium cause. Mr Vickers noted that manufacturing output rose 1.1% in the three months to November and he drew attention to a National Institute for Economic and Social Research forecast. Overall, there was no dramatic shift from the previous view on demand and output. He noted that retail sales indicators suggested a strong December. In the labour market the headline earnings growth rate was 4.9%, and the gap between manufacturing and services had narrowed. The claimant count rate had fallen in December, while the labour force survey rate in the three months to November was up on the previous three months. Employment grew by 60,000 between September and November compared with the previous three months, and inactivity was down 43,000 on the previous three months. There was no new data since the last Court on consumer or producer prices but house price indicators were strong in December.

Mr Plenderleith said there was no market disturbance as a result of the Millennium date change, though trading was thinner and there were somewhat softer money market rates, as expected. Sterling continued to edge up in the New Year, and there was no ready explanation for this. He pointed to factors supporting sterling in 1999, including improved growth in the UK and the rest of the world and the absence of inflationary pressures in the UK, as well as the existence of a responsible monetary and fiscal policy. Drawing Court's attention to chart 3, he said the interest rate increase had not changed expectations greatly. There were still expectations that rates might need to rise to more than 7% and even approach 7.5% by early 2001. Those indications were from futures rates, but he did not believe that analysts generally would sign up to that picture.

Sir Neville Simms noted that Edinburgh was doing quite well in the construction industry but otherwise he had nothing particularly new to report from his sector, and there was no change in the forecast. Reasonably strong growth was expected. He also noted, on a ten year horizon, a decline in the percentage of GDP spent on construction. It had fallen to 8% against 12%, which was the European average. More money should be spent on infrastructure. In Scotland, the picture was not greatly different from the national trend. The market was centred in the central belt, and the Edinburgh market was very strong, including retail and office building and a certain amount of regeneration. Glasgow was quieter. Modest overall growth was expected in the future in Scotland, with the caveat that there was little spending on basic infrastructure.

Mrs Heaton commented that as long as there was an expectation of interest rate rises it had an effect on the pound, and she asked whether the MPC looked at the merits of going faster, to where it believed interest rates should be. If rates went directly to 7.5% the expectation would then be of a fall rather than a further rise. The Governor commented that that was not necessarily the case, because expectations might be that increases would continue to 10%. Professor Buiter said that if there were a large increase there would be a large effect, and if it were gradual there would be a more gradual effect, but the cumulative effect should not be very different. Mr King commented that the real problem was that no one knew the level to which interest rates would have to rise. It would be a mistake to say that a particular rate would be appropriate over the next year and to move to it immediately. It was a month by month process, and the MPC came back each month and looked at the situation again.

Mr Bailie noted that the exchange rate was a subject of many of the conversations he had in Northern Ireland and the UK. There was surprise that exports were increasing in some markets. Middle Eastern and US markets were growing, but European business was being held at low margins. As the year ended, more attention would be paid to the real effect on margins. Mr Bailie had heard a lot of people questioning how long they could absorb low margins without withdrawing from markets or deciding on redundancies. He noted problems with the clothing and textile industries and also the difficulties for Northern Ireland firms that arose from sharing a border with the Irish Republic. These included high excise duties, which led haulage firms to relocate.

Mr Buxton said that corporate cash flow was relatively good, though some sectors such as agriculture were giving problems. Exports were not giving so many problems, apart from one or two sectors. There was a classic cycle underway in which companies cut margins to hold their markets and then set about improving productivity to live with the markets. He noted that the general corporate position across banking was pretty good. Dun & Bradstreet's count of failures was up, but they were still at a low level. On the personal side, he noted a growth in lending to individuals, while unsecured borrowing was falling from very high levels. Secured borrowing - the largest amount - was rising quite fast and there was quite a lot of equity withdrawal going on from the housing market, which was holding the figures up. If this continued, it was possible that there would be a certain number of problems in personal lending, perhaps later this year, because personal gearing had gone up and remuneration had not risen as fast as personal lending.

Ms McKechnie noted the Consumers' Association's quarterly consumer trend survey, undertaken between 7 and 13 January. The results were significant in terms of consumer confidence. She would hand them to Mr Vickers. People expected their savings levels to increase slightly in the next 12 months whereas in the previous 12 months they had fallen slightly. But precautionary savings had fallen very significantly. The survey showed that more consumers were planning to make major purchases for their homes.

Mr Morris noted Mr Vickers' comments on the manufacturing sector, and said it was not clear to what extent the improvement relied on existing resources, or whether buoyant investment was taking place. He was not sure whether it was possible to track investment figures for manufacturing over the period, but if it were it would provide a good pointer.

Ms O'Donovan said she was able to speak for a manufacturing firm which included interests in software and industrial electronics. She agreed that there was an improvement in the UK and Europe, but it was quite slow. Where additional smart technology was involved the company could increase prices but where existing technology products were concerned price increases were not possible. Overall price inflation was about 1%, while wage inflation was 2-3%. Unit labour costs were increasing, but total labour costs were flat or going down, as numbers employed reduced. The company suffered skill shortages in the UK and Europe, mainly of IT staff, who were moving to dot.com firms. E-commerce would show a very large increase in the areas the company was dealing with. Semi-conductors were now doing well, after the disasters of the past three to four years: any product selling to telecommunications or the utility sector was also doing very well. On the investment side, her company was still working at less than capacity in the UK.

Sir Ian Gibson said he expected the retail car market to have a difficult first half. Some manufacturers reported retail sales of minus 35-40% in the first ten days of January. Most manufacturers were in discussion with dealer networks on the restructuring that needed to take place because of the abolition of the block exemption and the growth of internet business. There were not enough people making enough money. Turning to components, he said his experience reinforced what Mr Bailie had said. Suppliers, having cut margins, were walking away from export business - or more disturbingly - there were a number of cases where multi-nationally owned groups were quoting on the basis of relocating to the continent. This was affecting some businesses that were big enough to influence the Department of Trade and Industry. He noted that the SMMT was leading a mission on behalf of the UK component sector to the German assemblers, including one which had a big investment in the UK. They had a feeling that they were about to lose their customer base and were going to Germany to make the case for keeping the business. He commented that expectations were not high from the mission. The message brought back by manufacturers would be interesting. He also noted that the collapse of the UK clothing supply business had severely affected the North East, and half a dozen businesses had disappeared in recent months. The perception was that it was related directly to the pound, and that the North East stood no chance.

MPC Procedures – a quarter in the life of an MPC member, and the provision of regional and sectoral information to the MPC
(Messrs Vickers, Plenderleith and Clark together with Professor Buiter and Mr Jenkinson in attendance)

In introducing his paper, which focused on the processes adopted by the MPC to meet its mandate under the Act and covered the provision of regional, sectoral and other information to the MPC, Mr Jenkinson said that it was an update of two notes prepared last year. The first part covered the procedures and organisation of the MPC in terms of the monthly policy round and the quarterly forecasting round. Changes since last year were highlighted in the note. There was additional emphasis on international development, notably the setting up of the new International Economic Analysis Division. There was also some restructuring of the pre-MPC day, and a reorganisation of the quarterly forecasting round to improve the focus. The second part of the note covered regional, sectoral and other information, and highlighted the role of the Agents.

[redacted] Sheila Masters said she had looked for an item on research and found it under ad-hoc meetings. She commented that the regional and sectoral part of the note was the more substantive part. She had been looking for more critique of what could be done better, and what more needed to be known. The paper was a description of what was currently provided rather than of what more could be done, and NedCo would value a paper that drew this theme out more. If the paper was to be taken again, she would like to know where the frontiers were, and where the MPC was pushing for better information.

Mrs Heaton commented that the Bank would be under more and more pressure from regional interests, particularly given the formation of the Welsh and Scottish Parliaments. There should be a firm objective of maximising the amount of regional statistical data. She knew the difficulty, which was that the samples were small. But data from the Agents was also statistically unsatisfactory, while nevertheless a major input to the MPC. She would like to see more of that side of the work developed. If it did become the case that there was increasing regional divergence in the economy, the MPC did not have the mechanisms to deal with it. But the Bank would be under great pressure, and might want to suggest that there were other ways of dealing with the regional issue. Mr Stretton said it would help him understand whether the Bank had enough regional and sectoral information if he knew more about why it was being collected. The knowledge of how the MPC used information and what those processes were would help in collecting the information. If interest rates changed, the MPC was working on an average for the UK, but it was important to understand how various regions responded to those changes. So Court had to have some feeling for whether the MPC was getting enough information. The Bank should be able to say that it had provided the Government with its current knowledge of what was happening in the regions, though the Bank itself could not do anything about it. In response to a question from the Governor about where Mr Stretton found this responsibility in the Act, he replied that the Bank was acting as agent to the Government and was not fulfilling its role properly if it did not make Government aware of the consequences of what it had to do. The Governor commented that all sorts of influences bore on what the Bank did. In reply to a question from the Governor, Mr Stretton said that if inflation control was going to demolish a particular sector of the economy, the Bank should make the Government aware. Whether anything was done about it was the Government's responsibility. The Governor said that the Bank was not a specialist in identifying such impacts. The current situation in the economy affecting certain sectors was very much to do with the rest of the world. The Bank would say that given the global situation, its decisions were producing a particular kind of result. If Mr Stretton was talking about looking forward, and forecasting the impact on regions and sectors, the Bank was not equipped to do that. The Bank would look at Mr Stretton's point. But the Governor did not believe that the remit could be extended to the extent suggested.

Commenting on Mr Stretton's point about the desirability of the Bank saying what it understood to be the impact on particular regions, Mr Allsopp agreed that the instruments were not available for the Bank to act. But he believed it would be right to say what the consequences were, to show that the Bank was publicly aware of its responsibilities. The Governor commented that if the issue was about explaining the past and the current situation, all that was swept up by the analysis. If it was a case of looking forward and saying that something would cause problems for particular sectors and regions, it was very difficult for the Bank to do this more effectively than the Government itself, and it would be very difficult to equip the Bank to do it.

Mr King said there was a potential trap, of buying cheap popularity by saying "if only the Government would do something about it." The Government could say that fiscal policy was wonderful, but don't blame us, because the responsibility lay with interest rates. It would be wrong to get into that kind of discussion. The Bank's role was to explain monetary policy and not to duck out by commenting on other people's responsibilities.

Mr Stretton replied that it was a matter of being able to say that the Bank knew the Treasury was aware of all the effects and that it was not the Bank's choice to prescribe what to do. If the Bank was not aware of the effects, its position was very difficult. Professor Buiter said that Mr Stretton seemed to be implying a forward-looking regional impact assessment of monetary policy to go with the Inflation Report. That would require a ten-fold increases in staff to achieve, and was an enormous job. The data even for aggregate analysis were inadequate. Mr Stretton noted that the Bank had a network of Agents that did improve its knowledge of how the economy would respond. The Governor said that the Bank collected regional and sectoral data to improve its understanding of what was actually happening in the economy, which was brought into the forecast for the economy in the aggregate. If the Bank tried to forecast for sectors and regions it would be a huge task and he would have no confidence in the

Bank's capacity to do that, even with much increased resources. The wording of the statute was to "take account of regional and sectoral information", not to forecast the implication for different regions and sectors.

Non-policy meetings of the MPC (Messrs Vickers, Plenderleith and Clark together with Professor Buiter and Mr Jenkinson in attendance)

Introducing the paper, Mr King noted that the first of a series of meetings had taken place in which the MPC as a whole discussed research priorities for the coming twelve months. The paper would shortly go back to the MPC spelling out the details including the names of individuals supporting members of the MPC in that work. Another meeting, not listed in the paper, had taken place after the forecasting round to identify issues for the next round. That meeting had been on 15 November.

Agents' issue of the month – skill recruitment difficulties (Messrs Vickers, Plenderleith and Clark together with Professor Buiter, Mr Jenkinson and Ms Bulloch in attendance)

In introducing the third in the series of Agents' reports which had been presented at pre-MPC meetings, Ms Bulloch said that the Agents had noticed a worsening of skill shortages last summer, and by October these were pretty widespread. They had asked their contacts who they believed were experiencing recruitment difficulties, and whether they were having greater difficulties in specific specialist areas or more generally. There were 123 responses. 84% reported shortages of some kind which were worse than a year earlier. The conclusions of the paper were that the problems recruiting specialist and more general skills seemed likely to persist; there seemed to be a significant structural element related to training; and greater generalised pay pressure seemed possible. The Governor commented that Ms Bulloch's presentation was a good example of the use the Bank made of regional and sectoral data, which informed its understanding of the labour market data and what it might expect to see across the economy as a whole. Mr Neill commented that it was an interesting paper which showed what was happening on the margin. He would be interested in understanding the impact of skills level across the country on Britain's ability to compete. Every business his company had taken over had management which showed little real understanding of how poorly skilled their staff were. This was a huge miss for the UK where technical skills were very, very poor, and was the biggest strategic crisis facing the economy in a rapidly changing world economy. It was not very well understood in London. Relative to Europe this was putting the UK at an accelerating disadvantage. Dame Sheila Masters noted that she was on the DTI Competitiveness Council. She believed there was a high level of understanding of the problem there. She noted the influence of Professor Michael Porter. At the last meeting of the Council there was a substantial discussion on skill shortages. But it was not being translated into any specific action. If people wanted to input to the discussion they should write to the Trade and Industry Secretary and encourage the Competitiveness Council to give the issue more priority.

FINANCIAL MARKET OPERATIONS ISSUES

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

Mr Plenderleith said that the Bank was moving into the next stage of a five to ten year project to modernise and enhance the safety of the UK settlement systems. The next stage was Delivery Versus Payment (DVP). It was necessary to link the real time payment system and the system for settling securities, a development needed to meet modern payment and settlement standards. In January 2002, it would be a requirement inside the euro area to meet DVP standards laid down by the European Central Bank. Mr Plenderleith described proposals to link the UK Real Time Gross Settlement system to the CREST securities settlement system, which was being addressed by CREST and the clearing banks. Part of that was the question of who bore the costs. It might be that the Bank of England would bear the cost of developing the core function for real time transfer arrangements. The Bank would like to recoup the ongoing operating costs from the banks while CREST could recoup its ongoing costs from its securities settlement customers. Sir David Cooksey said he was quite surprised to hear only of CREST, because London had a big financial sector. He asked what the arrangement was for other settlement systems. Mr Clark said that CREST handled the settlement of equities, domestic government and corporate bonds and money market instruments, so that it covered most domestic capital market instruments; but it was also one component of a wider move internationally. He added that, at the same time, significant changes were going on in the UK's payments infrastructure. The Cruickshank Report on the Banking Sector would almost certainly comment on the subject; and APACS, the umbrella body for UK payment services, was examining its own strategy.

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

Mr Clementi noted that the Trustees of the Pension Fund, headed by Mrs Heaton, had reported on the triennial valuation. It was now for the Trustees in consultation with the Bank to decide contributions by the employer. The valuation had shown a surplus of £108 million, and on this basis there would be a contributions holiday to 2002. There were some formalities to tie up. But he wished to inform Court where the Bank had got to in discussions with Mrs Heaton and her colleagues. He believed it was a very satisfactory position. In response to a question from Mr Buxton, Mrs Heaton said the total fund was £1.5 billion. Mr Buxton agreed that the surplus was a reasonable percentage. The surplus of 9-10% was not high, but probably justified a holiday. If it went higher it would move into the area where tax benefits might be lost.

The Governor drew attention to a paper by Mr Berkowitz on litigation against the Bank in the case of BCCI. He noted that there had been some difficulty in finding an appropriate panel of judges in the House of Lords to hear the case.

MANAGEMENT OF THE BANK

The future of New Change
(Messrs Clark, Plenderleith, Vickers and Midgley, and Shepherd of Drivers Jonas Chartered Surveyors, in attendance)

The Governor introduced Nicholas Shepherd, of Drivers Jonas, the Bank's property advisor, and said he was very grateful to him for coming to Edinburgh. Mr Clementi said that the Bank's overall property policy had been to rationalise its portfolio. New Change had been held largely as an investment property. The paper made clear that that avenue was no longer open because of the expiry of the Allen & Overy leases. He believed that Court would agree that it was no part of the Bank's job to be a property developer. The balance of argument was in favour of an outright sale. He asked Court for its views.

Sir Neville Simms said he though the paper laid out the pros and cons extremely well and made a lot of sense. The property had to be sold, and soon. The Governor asked Court whether it was content with the proposals in the paper. Court was content. Mr Clementi said that he was most grateful to Mr Shepherd.

The Annual Pay Review, including update on BenefitSelect
(Messrs Clark, Plenderleith, Vickers, Footman and Midgley in attendance)

Mr Clementi said that it was customary at this time of year to draw Court's attention to the annual pay review. He added that it was also appropriate to consider the BenefitSelect package at the same time. Progress was being made, though the situation was essentially the same as in December. The Union had been pressing for existing staff to continue on existing terms. The Bank did not accept this. There had been one or two developments. The issue had been reported in the press, but he did not believe the Union was encouraging this. Preserving perks scarcely struck a chord with newspaper readers. The Bank, for its part, had tried to keep the issue out of the press because it would inflame emotions among the staff. There had been a number of meetings with the Union, and the backing of Court had been helpful. There was now a greater recognition that the proposals were going to happen. That could be seen in the number of staff intending to re-finance their mortgage with the Halifax and other providers. It was proposed to write a letter to staff on Monday. He asked Mr Footman to take Court through amendments to the proposals and through the annual pay round, which he saw as a related issue.

Mr Footman noted that he had mentioned to the last Court that the Bank would look again at adjusting the packages for those losing housing loans. It was proposed to increase the £3.5 million lump sum to £4 million. The increase would be paid to about 200 people, of whom 75 were serious cases. The way to deal with the issue was through a lump sum. The Bank had indicated to staff that it was going to do that. There was still a great deal of insecurity and a strong reaction in some parts of the Bank to the proposals. There was a real concern in some parts of the Bank about the prospects of redundancy. This was not just in Central Services but also in Banking where there were no current plans, but people felt there might be in the future. A review of services in Banking was underway. At present staff made redundant or taking flexible retirement could take their subsidised loans into retirement. So by not having subsidised loans, the Bank was making the redundancy package worse. Staff were very conscious of that. It was proposed that if staff were identified for redundancy before 1 April they could keep their existing benefit terms. If they were subsequently identified for redundancy, it was proposed to have a tapering scale over five years for enhancing the existing redundancy payments. The proposals were to address the anxiety in a number of parts of the Bank about the risks of redundancy and the effects of redundancy on the benefits package.

Mr Footman believed that the end game was approaching. There remained strong resistance among parts of the staff and in the Union. He noted that no formal claim had been lodged this year for the annual settlement. But the Bank felt that this should be taken side by side with the benefits review. It was proposing a mix of pensionable pay and bonus. Parts were negotiable and parts were not. The previous year, the Bank had put into the pay budget a mixture of discretionary and across the board payments amounting to 5.75%, together with a 10% bonus. This year it was proposed to have a total of 7% for pensionable pay and a 7.5% bonus. Within the pensionable pay, less would be discretionary and more across the board. The intention was to address the areas where resistance and fears about the benefit package would be greatest. So the proposal was a 7.5% bonus, 3% pensionable merit money financed by churn and a 2% across the board payment linked specifically to BenefitSelect. Finally, for banking staff there would be a 2% award for satisfactory performance. By having more pensionable pay and paying more across the board pay and linking it to benefits the Bank felt it would be providing adequate compensation in a context where it was going to have to impose the package because it was unlikely to be accepted at a ballot. The Bank needed to show it had a strong business case and had demonstrated that very clearly. It also needed to demonstrate that it had provided adequate compensation and it had done that. So the Bank could demonstrate if it were taken to a tribunal that it had without doubt provided adequate compensation for the changes.

Sir Neville Simms said that it seemed to him that the Bank was buying acceptance of the Bank's benefit package with a 3-4% pay rise. It would not be easy to come to Court to ask for anything much above 3%. He asked whether the Bank was spending 7% on pay increases. Mr Footman said that the figure was taking pay and benefits together. Separately, it comprised 2% across the board for banking staff and 3% of recycled funds, not new money. The money that financed promotions came from senior staff leaving and juniors joining, which paid for the scale increases. This was normally announced at the time of the pay review because what determined the new pensionable pay of staff was a mixture of promotion and across the board increases. He noted that the previous year the comparable figures had been 2.25% and 3.5%.

There was an additional 2% this year specifically geared to BenefitSelect. Sir Neville said it was important to be careful not to confuse where the money came from and to face up to what the Bank was giving staff and what part was RPI related and what part was promotions. It still sounded as if it were a 5% wage award and another 2% to buy out benefits. Mr Footman said that the across the board increase was 4%.

Sir Neville said that he was concerned that the Bank might appear to be paying 7% in pay rises this year. Sir Chips Keswick said the Bank was understaffed and lacked expertise in certain areas and had a great difficulty competing with the private sector. Whether it was 3 or 5% was irrelevant.

The Governor commented that if the increase in the pay bill this year was compared with last year, the numbers proposed no difficulty. Mr Midgley said that even after the proposed increases the pay bill would shrink, and taking account of the numbers in the Annual Report, the pay bill per head would on average represent an increase of just over 5%, which was the average of the last few years. The 5% was driven by three factors - an across the board pay increase, smaller bonuses relative to last year and a compositional shift in staffing.

Mr Morris commented that it was clear that the management was motivated to try to get the benefit package through by more generous provision than in normal circumstances. So there needed to be a clear distinction between the across the board inflation pay increase and what the Bank was prepared to offer to offset the benefit loss. He expressed a hope that the Bank had written to staff about the changes. Mr Footman said that the Bank had written in November and would be writing again.

Mr Morris asked whether the Bank would be saying on a collective basis that this was what it was proposing to do and that the money would be credited to peoples' wages, or whether it was asking individuals to sign an agreement. He also asked whether there was wage drift in the pay structure beyond the budget. Mr Footman said, on the latter point, that there was a little for overtime. The Bank had formally written to staff, and when it made its final offer including pay proposals, it would write again and make clear that the Bank would offer new contracts on the basis that the benefits package and the offer would only be open to those accepting the new contracts. There would then have to be a point at which notice would be given that existing contracts would be terminated. He noted that there might be a small number of difficult cases but the Bank had very carefully taken legal advice.

In presenting the proposals to staff it would be made very clear that 2% was related to benefits, 2% was the normal across the board satisfactory performers' increase, though the latter would not be for all parts of the Bank. Staff would see 2% across the board and 2% almost entirely across the board. On top of that, there was discretionary money which was not negotiated with the Union. Relatively more pensionable money would be offset by lower bonus. The other part of the cost would be less flexibility. In a normal year the Bank would wish to distribute pay in a more flexible way but this year would revert briefly to a more across the board process.

Mr Neill said that in a steady state the Bank's objectives should be to reduce the pay bill year-on-year through efficiency improvements. Individuals should get an annual appraisal that should give a pay increase which recognised inflation but was not linked to it. There should be no question of 2% for this and 2% for that, which was philosophically wrong. A third element should be based upon the performance of departments in the Bank. He acknowledged that there might be some special circumstances at present, because the Bank was restructuring benefits. He also noted that no claim had been received and that should be seen as a precedent, because it was management's job to decide.

Mr Clementi said the Bank agreed with all the principles put forward by Mr Neill. It had been reducing the pay bill year by year. It had annual assessments, and it was part of the bargaining with the main banking unit that there was an across the board satisfactory performance settlement negotiated with the Union. He was not particularly happy with this situation. The Bank would like over time to move away from across the board settlements but this would be resisted by the Union. It was, however, necessary to take one step at a time. Once past 1 April, there would be very much more transparency about what the Bank was paying staff. At the moment there were huge discrepancies between different people doing the same job. Mr Neill said he was very happy if that was the direction in which the Bank was going.

Mr Buxton said he supported the principle of paying extra this year to get the package through. The one concern he had was the fact that the Bank had regressed on flexibility. Bearing in mind what Sir Chips had said, parts of the Bank needed to recruit more and it needed more flexibility on pay, to be able to allocate more money to improving the competitiveness of the pay package. The 3% figure was muddying waters. More flexibility was needed and he hoped that in future the Bank would come back to an across the board award together with a variable amount that could be used in a flexible way across the pay spectrum.

The Governor commented that flexibility was where the Bank had been headed and where it wanted to be headed. But this year, in order to keep faith with some of the people disadvantaged by BenefitSelect - and there were some - the Bank had interrupted that process. Once through the BenefitSelect process, the Bank would then continue on the path on which it had been before. Some of the across the board money could then be released to extend flexibility and reward on the basis of merit.

Sir David Cooksey said his understanding was that the greatest difficulties were with subsidised mortgages, and he asked how the Bank was going to recover mortgages it had already provided. Mr Footman said that the mortgages had been outsourced some time ago to the Halifax with the Bank providing the balance of interest to the Halifax.

The Governor said that to carry forward the negotiation Court needed to agree on the 2% plus 2% formula. Did Court agree that the Bank should offer 2% compensation for BenefitSelect across the board to everyone and 2% to all bargaining units that normally receive across the board awards. The Bank would inform Court on progress with the 3% merit awards. Court was content with the proposals.

Proposal for external review of IT
(Messrs Clark, Plenderleith, Vickers and Midgley in attendance)

Mr Clementi noted the discussion of IT strategy at the previous Court meeting and said that it appeared a good idea from the management side to have a high level review of IT strategy with a small team of three or four. The proposed terms of reference had been circulated to Court and he asked for views on the proposal.

Ms O'Donovan said it was an eclectic list of consultants, mixing implementers with strategists. Mr Clementi said the list was drawn up partly in-house and partly on suggestions from

Directors. The Bank intended to write and ask those on the list to provide a note which would lead to the selection of a short list of two or three firms. In response to a question from the Governor, Ms O' Donovan said she found the list surprising. For example she knew the FI group well, and they were implementers and not what the Bank would want. She was also surprised not to see the likes of Andersen and PwC which were capable of analysing both business strategy and IT. The Governor said he knew Ms O'Donovan had a lot of experience in that field and he thanked her for her help. Mr Buxton noted that he was a Director of FI Group, and he believed that Ms O'Donovan was out of date. He said that a more fundamental point was whether, rather than start with the management structure, the review should start at the other end, and conclusions should emerge from what the Bank learnt about its IT systems. The Bank should get somebody to look at the systems and produce a management structure out of that. Mr Clementi said that approach had been considered but the Bank was small enough for consultants to get a feel for systems. If they started with the systems, of which the Bank had a huge number, it would be a much longer process. The Bank wished to get an overall view from the consultants about its approach. Dame Sheila Masters declared an interest as a partner of KPMG and a Governor of the London Business School. She said that spending time on detailed terms of reference was not worthwhile. The important thing was to discuss with the consultants their views of how they perceived the problems involved. The Bank as customer would choose the consultant who was most alert to the issues about which the Bank was worrying. Mrs Heaton agreed that it would be better to appoint a business strategy type of firm rather than an IT firm. The Governor asked Court whether it was content to leave the issue for the Bank to decide. He noted that the Bank had asked Mr Neill if he would be a sounding board. It would be very useful if, at that early stage, it could bounce thoughts off him.

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

Mr Midgley drew attention to the front of the report, which he said summarised all the issues. Sir Neville Simms asked how the outcome on the distribution of banknotes over the New Year period compared with predictions. Mr Plenderleith said the predictions were almost spot on. The Governor noted that there had been very little recourse to emergency cash.

Report from the Chairman of the Audit Committee
(Messrs Clark, Plenderleith and Vickers in attendance)

Mr Buxton drew Court's attention to the draft minutes of the Audit Committee held in December. He said that the middle office programme had started. He also noted that the Turnbull report needed to come to Court. There had been discussion in the Audit Committee, which had felt that it was not really a matter for Court. However, the Committee had a duty to make sure Court was briefed and accepted the Turnbull principles. So it should go to Court as soon as possible. He noted that the audit tender process was starting and Ms O'Donovan had agreed to take part. Finally he commented that FRED 20 seemed to be a most extraordinary decision by the accountants and he hoped that all members of the Audit Committee and the accountants on Court would argue against it. The idea of putting the pension surplus into the accounts was extraordinary bearing in mind legal decisions on where that surplus belonged. Dame Sheila Masters said Mr Buxton was not alone in criticising FRED 20.

The Governor thanked the Audit Committee and he thanked Court for coming to a meeting in Edinburgh. He also thanked Mr Stretton for providing the meeting with splendid quarters.

The meeting ended.

Sheila V Masters
16 February 2000
Peter Rodgers
16.2.00

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 16 FEBRUARY 2000

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 Buxton

Sir David Cooksey

Mr Davies

Sir Ian Gibson

Mr Hawker

Mrs Heaton

Sir Chips Keswick

Mr Morris

Mr Neill

Ms Kathleen O'Donovan

Sir Neville Simms

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

MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court and an update on International Economic Developments
(Messrs Vickers, Clark, Bailey and Jenkinson in attendance)

Mr Vickers noted that the February Inflation Report would be published the following day. He described the overall economic picture as one of stable inflation and steady growth. He said the sectoral balance across the economy had recently been better than for some time. Industrial production had increased. However, the strength of sterling suggested the possibility of greater future imbalances both between sectors and between domestic demand and net trade. GDP grew by 0.8% in 1999 Q4, up by 2.7% on its level a year earlier. This quarterly GDP growth rate was a little above most estimates of trend growth. Within the total, services output grew by 2.9% and manufacturing by 1.9% over the year to 1999 Q4. Industrial production had fallen in December but it was not clear whether or not this was Y2K related, perhaps due to longer holidays and production down-times.

Near-term prospects remained reasonably robust. Leading indicators of consumer spending suggested continued strong growth in January: consumer confidence had risen to +8 in January from +1.7% in December on the GfK measure; wealth was rising rapidly (both housing and financial wealth); and lending to households also remained strong. The one exception seemed to be the car market where demand was weak.

Business investment had slowed markedly in 1999 and was an uncertainty looking ahead. Investment fell by 1% in 1999 Q3, the first quarterly fall since 1996 Q4. But this might reflect a Y2K related pause in spending. The Bank's Agents were currently investigating this issue so the MPC could better assess investment prospects. The recent trade data painted a less rosy picture than was evident in the middle of the previous year. Mr Vickers said that if the high exchange rate was maintained, there was likely to be a renewed deterioration in the external position.

The latest labour market data showed a 75,000 rise in employment between October and December, and a fall in unemployment on the claimant count measure of 9,800. But the most striking aspect of the data was the increase in earnings growth. The headline annual rate (October-December) rose to 5.5% from 4.9%; and the year-on-year increase for December alone was 6.2%. Mr Vickers said the data were naturally a concern but should not be taken at face value.

On the prices front, producer output prices had edged up further in January rising by 1.8% on an annual basis (excluding taxes and duties). In contrast, input prices had fallen in January despite the rising oil price. Since the previous Court meeting, the price had risen by around $3 to $28. Retail price inflation fell 0.1pp to 2.1% in January on the target RPIX measure. RPI increased to 2%. The annual HICP inflation rate fell 0.4pp to 0.8%, the lowest rate in Europe.

The growing difference between the HICP and RPIX measures was partly being driven by higher housing depreciation, which was excluded from the harmonised measure, as well as other differences in coverage, for example cars. The gap between goods and services price inflation widened further in January (0.0% and 4.2% respectively).

Commenting on market developments, Mr Vickers noted the continued weakness of the euro and also the recent decline of the dollar against sterling. Short sterling futures had eased back in terms of the implied 3-month interbank rate. Market expectations for the repo rate had increased following the release of the latest labour market data. Equities remained strong, led by technology stocks. This included the Japanese index which had gone above 20,000 in recent weeks.

Mr Neill said that, in relation to earnings, loyalty bonuses to IT staff were paid in January, reflecting Y2K related work. But bonuses for other staff had generally not yet been paid. The car market remained depressed. Recent data showed overall sales down 3% on a year earlier; and private consumer rates down 9%. Cheaper volume cars were selling reasonably well but the more up-market badges had seen large declines. He suggested that the car market was currently less an indicator of demand and more a clue to consumer psychology. Consumers know they can buy cars cheaper abroad. To date, the manufacturers had not responded. They were reluctant to reduce prices in the UK as this would undermine their marketing strategies. Mr Neill said that across manufacturing as a whole the high exchange rate was the key concern and the pressure on UK firms was considerable, even amongst those that had achieved productivity gains. He expected a number to withdraw from export markets or UK production.

Mr Buxton said that lending to consumers was slowing from the high rates seen this time last year and this was expected to continue. Credit card lending was also slowing. In contrast, mortgage lending was growing more strongly than a year ago. The high level of borrowing in December had continued into the New Year. He expected consumer 'strain' indicators to increase; for example, lending as a proportion of earnings was high and, although the ability to pay was reasonable, higher interest rates would mean this would start to deteriorate.

Lending to the corporate market remained healthy with no real signs of strain. Income from property was at high levels. Lending to the manufacturing sector was flat. The sector's cashflow was positive so had not resulted in an upturn in distress borrowing. In part, this was related to the high levels of corporate bond issuance, which remained a buoyant market.

Sir Neville Simms confirmed that, in general, annual bonuses had not yet been paid. Wage costs in his company had risen in total by around 3.5%, including promotion costs. He believed this was probably indicative of the construction industry at large. In relation to the state of trade, he said the industry anticipated volumes to continue growing over the coming two years. Construction orders had fallen by around 9% in 1999 compared with a year earlier. This largely reflected a weak first half of the year. The second half of the year had appeared more buoyant than the data suggested it was, though there remained doubts about the DETR figures. Tender price inflation was expected to stay fairly subdued despite rising activity. In part, this reflected some slowing in the rate of pressure on labour costs where, even in the south-east of England, there was no sense of wage costs spiralling.

Sir Neville also referred to the progress of the Private Finance Initiative. Considerable cost savings were being realised for the Government as projects progressed through the process. In relation to the situation in the West Midlands, he noted that the latest increase in interest rates had not been well received. At a recent CBI regional council meeting he had noted a number of references to companies planning or considering moving activity out of the UK.

Sir David Cooksey followed this point by also noting the evidence of increased purchasing of components and materials abroad by UK firms. He also said that after the apparent pause in IT spending, projects were not being reconsidered very quickly to date. In relation to retail sales, after a strong December and early January, Sir David noted that growth had dropped back quite sharply since, and sales were well below the same period a year ago.

Sir Chips Keswick referred to his recent visit to the United States where he had been told by a number of parties that oil price expectations were now in the $35-40 range for later in the year.

Commenting on international developments, Mr Bailey said that the United States continued to grow strongly and had now experienced its longest period of continuous growth on record. The former crisis economies of Asia continued to recover. Recovery was less impressive in the Latin American countries, in part reflecting their later stage in the recovery cycle relative to the

Asian economies. The EU economies were also furthering their recoveries. The exception to this positive global picture remained Japan. On the prices front, the oil price had moved higher in contrast to other commodity prices, which were generally more subdued. However, further rises were anticipated as global demand rose further. In response to economic developments, interest rates had increased across much of the world, again with the exception of Japan. Imbalances between internal and external positions characterised a number of countries. He said that there remained questions about the sustainability of growth in the United States. Equally, there was debate about the extent and impact of supply-side improvements. The largest downside risk to the United States probably remained a sharp asset price correction. In contrast, Europe had capacity to grow strongly but the issue of supply-side reforms remained relevant to prospects. As to the impact of higher oil prices, Mr Bailey said that we were clearly in a situation where OPEC mattered again. However, the impact of higher oil prices to date was nothing like earlier episodes, though we would need to continue monitoring the pass-through and analysing the contrast with the past.

Mr Allsopp remarked that he recognised there were risks to the United States and the debate about new paradigms was inevitably inconclusive. But he was not convinced that the imbalances in the US economy were a significant risk. A low savings rate needed to be considered alongside high productivity growth. And he felt that the link between a stock market correction and the wider economic situation was far from clear. Mr Bailey added that Alan Greenspan had been making more of the link between productivity growth and the strength of the stock market in recent months.

Mr Allsopp inquired about whether the deterioration in the US balance of payments position ought to be a concern. He commented that if potential growth was higher than previously the case, then the external balance might well worsen. Mr Bailey agreed that this would be a consequence and that higher growth would sustain a higher current account balance for a time.

Mr Neill commented on the impact of e-commerce and the internet. The effects were pervasive and it was difficult to judge the pronouncements by some companies about the large costs reduction that they envisaged achieving. But he felt it was essential to get a better handle on these issues. The Governor said that the Bank was very conscious of the importance of these issues, but also the lack of precision in judging their impact. Mr King said there was certainly little to clarify the impact in existing data. It was important to have an open mind about detecting evidence. But he thought it was often too easy to make assumptions. He said all new innovations were likely to have a beneficial effect on productivity. Importantly, he did not think the relationship between higher productivity growth and inflation was as straight forward as many commentators implicitly assumed. He said a situation could be envisaged where an investment and consumption boom preceded an actual increase in trend productivity growth as firms and individuals anticipated higher incomes. This might necessitate higher rather than lower interest rates.

Sir David Cooksey referred to the growing gap within the corporate sector, reflected in stock market valuations. IT or "dot.com" related companies were the source of rising stock market prices. The contrast between these and more regular companies was growing larger and this, in turn, was impacting on the cost of capital for the different firms. Mrs Heaton added that stripping-out high tech firms suggested the rest of the market had in fact crashed, with many companies' share price down 20-30%. She felt Mr Vickers' description of the stock market as "coming off the top" was too mild. Mr Vickers said there was a disaggregated analysis of the stock market in the February Inflation Report. He did not feel the term 'crash' best described the market excluding IT stocks. Ms O'Donovan suggested there was little comparison in the past to match the falls some firms had experienced.

MPC Procedures – resources available to the MPC
(Messrs Vickers, Clark and Jenkinson in attendance)

Mr Jenkinson introduced the paper which covered three aspects of the issue of resources available to the MPC. First, it updated Court on the new arrangements governing the relationship between Monetary Analysis and the MPC in establishing work priorities. There was, additionally, information on the dedicated MPC research staff. Second, it outlined the resources assigned to monetary policy work within the Bank. Mr Jenkinson noted that there would be challenges in securing the staff in line with the budgeted allocation. Third, the paper offered staffing comparisons with other central banks. In terms of the number of economists, the Bank's position was broadly similar to other major central banks.

Sir Neville Simms said that he felt the number of resignations from Monetary Analysis was surprisingly high. Mr Jenkinson shared his concern. He said the main reason for the outflow was the pull from the City in terms of salary and profile, notably amongst analysts in their late twenties and early thirties. The Bank's relative advantage was its ability to offer policy-related work and research opportunities. The remuneration strategy had been adjusted to offer more rapid salary progression to this group and the new benefits system was also aimed at assisting recruitment and retention of economists.

The Governor remarked that the Bank was very fortunate to have such high calibre staff but that meant it was in a very competitive market. Mr Allsopp said that he felt this outflow was inevitable and likely to be ongoing when progression was within a pyramid structure. He asked if these outflows had increased over the recent period. Dame Sheila Masters said she presumed exit interviews were undertaken when individuals left and asked if economists were also lost to other areas of the Bank and, if so, why was this the case given the attractions of working in Monetary Analysis? Mrs Heaton asked if secondments from the City were an option and had they been considered.

Mr Jenkinson said exit interviews were undertaken when people left the Bank but moves within the Bank were part of the internal assessment system. He said that part of the reason for analysts leaving for other positions within the Bank was the growing demands elsewhere for economists. The upgrading of economic analysis across the Bank was providing additional opportunities for advancement for MA economists. Over time it is hoped that this flow would be two-way. Regarding inward secondments from the City, Mr Jenkinson felt pay would still be an issue, both in terms of attracting secondees and the impact on relativities with Bank staff.

Mr Vickers said it was very difficult to determine what was a normal level of outflow when so many areas of the Bank were changing. That said, he thought the number in the report of an outflow of forty (compared with an inflow of fifty) was abnormally high. The Governor added that he also felt it was high but the basic proposition had been with us a long time. He said he drew comfort from the fact that the Bank had progressively increased its capacity over time to undertake high quality economic analysis, driven in large part by Mr King.

Dame Sheila Masters asked if the Bank had considered the consequences of being unable to recruit sufficient new people. Mr Jenkinson said what tended to give when resources were constrained was longer term research. In the current circumstances it was recognised that not enough resources were being devoted to research into longer term structural issues. Dame Sheila asked if some of these research projects could be outsourced? Mr Jenkinson said this was being considered. The Governor concluded with the observation that Court appeared more concerned with the Bank's ability to meet its budget in this area rather than the budget itself.

FINANCIAL STABILITY ISSUES

Domestic Developments and International Issues
(Messrs Clark and Vickers in attendance)

Mr Clark highlighted three current priority issues within the Financial Stability Area.

First, payment and settlement systems, where he drew attention to the Cruickshank Review. The Review was expected to conclude over the next month or so and was likely to comment and make recommendations on UK payment arrangements and their oversight. But this was just one of a number of current developments with a potential impact on payment arrangements. A European directive, the Settlement Finality Directive, which came into force in the UK in December 1999, required the Bank to "designate" payment systems which were to benefit from the protection provided by the Directive. In addition, new international codes and standards relating to monetary and financial policy recommended transparency about responsibility for monitoring payments systems. And the G10 central banks Payments Committee had endorsed a set of core principles for payment systems, which again indicated the need for clear oversight responsibility.

Second, Mr Clark mentioned the much wider international exercise on codes and standards which was at present underway. Codes relating to payment systems were only one of around fifty under consideration by various authorities. Thought was now being given to practical programmes for their implementation. Sequencing and prioritising was a difficult issue, as not all countries were at similar stages. Incentives to encourage implementation were important, but also contentious. The emerging economies were nervous about anything which smacked of additional conditionality; the IMF were worried about having to make precise judgements against criteria which were fuzzy; and the standard setters were unsure that their standards should be used in that way. In the longer run, market incentives were likely to be crucial and here transparency was the key. Finally, monitoring of compliance was likely to require considerable resources – mainly staff – that were not currently in place. Additionally, there was a question of who to engage effectively with countries outside the G7. This matter was to be discussed at the G7 Deputies and IMF Spring meeting.

Third, he said that in November 1999 the Bank was given a remit to report annually on the issue of financial exclusion. This related to the work undertaken on small business finance but was, at the same time, a distinct topic. The Bank was currently looking at the question of effective data collection in this area, and particularly regional data.

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

The Governor proposed that Court's next meeting outside London should be in Leeds. He noted that the meeting in Scotland had worked better than the visit to Birmingham and the surrounding events had been more successful. The Scottish visit would be taken as a model with a sit-down lunch with speeches, rather than a buffet. The Bank would pursue the question of a date for the Leeds meeting and report back to Court. Mr Buxton asked whether the Bank could get away from the pattern of going in January because the weather might be disruptive and it might be better to go later. The Governor said that Mr Buxton's point about January would be explored.

Mr Clementi reported that NMB was sold on 28 January and the price allowed for a small write-back in the Bank's accounts. In response to a question from Sir Chips Keswick, he said that only limited warranties had been given.

Reporting on the Middle Office, Mr Clementi said that the Audit Committee was familiar with the issue. It had been agreed that once set up and working properly this unit was to become a Division in its own right. Mr Ingram would be the Head of Division. He also noted that

Mr Colin Mann would be Head of the Banking Services Division, formerly headed by Mr Bartlett, and the position of Head of MSD would be filled by Mr Brookes.

Turning to benefits, Mr Clementi noted that the Bank had reached agreement with the Printing Works, Gloucester and the Services Bargaining Unit. Relations with UNIFI were a good deal more difficult. The Union had continued to argue that staff with subsidised mortgages should be permitted to remain on existing contracts. A letter had been sent to staff on 4 February asking them all to sign up to the new terms. The legal position was that the Bank could not unilaterally amend existing contracts. But it could withdraw old contracts provided there was a good business reason, there had been proper consultation and there had been proper compensation. He believed all three tests had been met. The letter said that the Bank was inviting staff to sign the new contracts and it noted that, if they did not, the Bank had the right to withdraw existing contracts. In some quarters there had been concern, and some had taken offence at the letter. The Bank had said that it was following legal advice, and took the view that it was fair to set out clearly in advance for staff what the underlying position was. The Union had complained, and there had been a demonstration of 200 staff outside the Bank the previous week. The day before Court, the results of a ballot had shown that, of those voting in the Union ballot, 66% of the staff at the Printing Works were in favour of the new proposals, 88% at Gloucester - whereas in London 2/3rd of the staff were against and 1/3rd were in favour. The Bank had made clear that it would continue with the implementation of the new proposals. It could not be ruled out that the Union would wish to take legal or other action but industrial action as such appeared unlikely. Mr Clementi expected to be able to confirm on 24 February that the great majority of staff had signed up.

He noted that the Financial Times had implied in an article that Monetary Analysis was a loser from the proposals. This was completely wrong. The Monetary Analysis area was "poor" in benefits, as staff were relatively young and a smaller than average proportion had mortgages. Monetary Analysis was a substantial winner, and in fact had a hidden increase in pay as a result of the proposals.

Returning to the Middle Office, Mr Buxton asked to whom it reported. He noted that the Audit Committee's original view was that it should report to a Deputy Governor. Mr Clementi said that the proposals set out for the Audit Committee were that the Division would report directly to Mr Plenderleith. For management reasons this was more convenient. It was not easy for Mr Clementi to run a Division himself. But Mr Ingram was also Secretary of the Assets & Liabilities Committee which reported to Mr Clementi, and Mr Clementi noted that in running that Committee he had the right of direct access to Mr Ingram. He had taken advantage of that right. Mr Buxton said that that was the compromise proposal put to the Audit Committee, which was accepted, and his question was aimed at checking that it had been implemented.

Mr Davies said that the Financial Services Authority had six people, among the 450 who had moved from the Bank, who were still on TUPE terms. Mr Footman said that the Bank's Personnel Division had been talking directly to the FSA's Personnel Department about those six people. Bank staff had been given a signal that the Bank might be in a position to give them notice, but it wanted to avoid that if it possibly could. If notice were given, the terms of the existing contracts would run for the duration of the notice period.

In reply to a question from Dame Sheila Masters, Mr Clementi said he expected the great majority of staff to sign the new contracts. People who complained they were worse off were generally those who wanted to use their benefits points to maximise holidays and did not have enough points. Very few were worse off. He noted management's firm intention to go ahead with the proposals. Court had given its backing and staff now knew that the Bank would not back down. The Bank would decide how to treat those who did not sign in the light of the numbers concerned, but it had put staff on notice that it had the right to withdraw the old contracts. Mr Neill said he was in full agreement. The Governor said that the Bank found encouragement in the fact that when people went to independent financial advisers they came back reassured. A lot of those affected had had difficulty in understanding the overall impact on their finances.

MANAGEMENT OF THE BANK

Finance

The Bank's budget for the year 2000/01
(Executive Directors, Messrs Midgley and Footman in attendance)

Mr Clementi said that Mr Midgley's paper sought Court approval for the Bank's budget for the next year, reviewed the level of cash ratio deposits based on an assumed rate of return, and sought Court's authorisation for the Governor to write to the Chancellor relaying Court's conclusions in relation to CRDs. It also sought Court's agreement to a proposal for the wording of Bank Objective 9. He noted that while the Profit and Loss account might have similarities to those in the private sector, the Bank was not a profit maximiser. Expenditure control was one of the keys to its management approach. The most important question about the budget before Court was whether it reflected the overall strategic direction of the Bank.

The Bank should plan to run its process businesses - printing, banking and the Registrar's Department - more effectively. It should continue to build analytical capability in Monetary Analysis, Financial Stability and in Market Operations. It should reduce overhead areas.

He noted that on page 6 a net reduction was given of £4.1mn current spending, but this was the outcome of several changes. There were savings of £6.7mn primarily at the Printing Works but an increase of £5.6mn in the analytical areas and a reduction of overhead costs of £3.1mn. He noted that one or two overhead areas were increasing, for example the Press Office, which supported the MPC, and training costs in Personnel. He drew Court's attention to a table projecting the headcount over five years.

Mr Clementi noted that CRDs had been set at 0.15% in the Spring of 1998 as part of a five year deal. Interest rates were at the time 7%, but short yields were now lower. Last year, there was a prima facie case to approach the Treasury over the level of CRDs, but the Bank did not recommend that last year and neither did it recommend such a move this year. Because a proportion of assets were held in long gilts, they were a cushion against a reduction in short rates. So the Bank's costs were more or less covered. The current CRD rate led to an overall return on funds in excess of 7%.

Mr Clementi drew Court's attention to a proposed wording for Bank Objective 9 as follows: "to maintain the Bank's overall spending within the agreed budget of £212.2mn for 2000/2001 set by Court in the context of the medium-term framework for its finances, which called for a £20mn reduction in overhead costs over the five year period to 2002/2003." Mr Clementi said the Bank believed this was an appropriate target. He hoped Court would be able to approve the budget and he, the Governor and Executive Directors would be happy to answer any questions Court might have.

Mr Buxton said he hoped that the review of IT practices would bring down costs in the Bank. Experience showed that once good IT practices were in place savings tended to be very much more than expected. There was an assumption that deposit margins on foreign currency balances would drop. He suspected that costs should, instead, drop, while margins should be maintained. He would expect that sort of outcome to be the result of the IT Review's effect on costs. The Governor agreed that this should be true of both the IT and the broader banking services review.

Mr Buxton, turning to CRDs, said that he believed the banking industry would be happy with the existing 0.15% level. But a number of factors in the CRD calculation were altering, and he believed it would be helpful if the Bank could flag these factors to prepare its position better in the banking industry if there were a need for a future change. In the meantime the industry would be happy with 0.15%. The Governor said that was a valuable point.

Mr Midgley said that the underlying position with CRDs was no different from a year ago. More was being spent in analytical areas, and less on overheads. One change that made CRDs look slightly better compared with a year earlier was TARGET. The return on TARGET balances this year was more than the costs to the Bank. Sir Chips Keswick said there was a slight unreality about the situation. CRDs were justifiable only if the Bank provided something to the banking system, but it had lost supervision to the Financial Services Authority. Another element to bear in mind was that the Bank had in the past depended on a burst of inflation every 10 years and had enjoyed the benefits of the subsequent run down period. The Governor said it was questionable whether that was an issue for this year.

In response to a question from Dame Sheila Masters about the future of New Change, Mr Midgley said it was hoped to put it on the market in June and complete the sale by the year end. Mr Clementi noted that Sir Neville Simms' advice in Edinburgh was to put the property on the market as soon as possible, and this advice would be acted upon.

Sir David Cooksey noted that there seemed to be a discrepancy between the paper presented earlier by Monetary Analysis, which showed a shortfall of nearly 40 people compared with the budgeted position, set against the table in the documentation for March 2000 which appeared to imply a shortage of only 18. Mr Clementi said the figures were reconcilable, and the Governor asked him to report back on that to Sir David outside Court.

Mr Davies said that one of the arguments Court found attractive for the new benefit package was the saving in overheads it would provide. He hoped this would lead to a reduction in costs in Personnel. Mr Footman replied that the Budbook showed a fairly sharp reduction in staff in Personnel, and part of this was because of the removal of staff administering housing loans and other benefits. That accounted for a fair part of the reduction from 85 to about 50 staff over three to four years. He noted that there were also direct expenditure and systems costs associated with the change, and a continuing need for direct expenditure on training and recruitment, through outsourcing or the use of external facilities. The cost of training, and particularly the computer literacy programme, was going to be an off-set to the overall reduction in Personnel.

Court APPROVED the Budget, the paper reviewing the level of CRDs, the proposed letter to be written by the Governor to the Chancellor relaying Court's conclusion in relation to CRDs, and the wording proposed for Objective 9.

Other items

The Turnbull Report
(Executive Directors, Messrs Butler and Footman in attendance)

Mr Clementi noted the Turnbull Report's guidance for directors on maintaining a sound system for internal control, and said that the Bank would need to make a statement of compliance in the 2000/2001 Report and Accounts. It had examined the current situation and judged that it largely met the Turnbull requirements, but some changes had been identified to reach full compliance which would need to be described in the Annual Report. These were set out on page 4 of the note.

The proposals were:-

> To introduce a procedure under which the Executive Directors' report to Court once each year on risk management in each of their areas of responsibility. To do this effectively they would need to have in place added mechanisms of upward reporting on the control of risk.
>
> Secondly, to reassess and refresh the current risk matrix, taking account of any new activities or processes and mapping the Turnbull principles to current practices in the Bank. It was aimed to produce a summary version to aid Members of Court in understanding the principal risks affecting the Bank's responsibilities and operations.
>
> Thirdly, it was proposed to review the delegations and policies set by Court and how they were applied by management across the Bank.

Mr Butler noted that the Bank had already carried through a number of changes relevant to Turnbull. In particular there were the changes relating to the Bank of England Act 1998, including the overhaul of the role of Court, the setting up of NedCo and also the revision of the Audit Committee Terms of Reference and Matters Reserved to Court. Furthermore, a Section 39-style review of the risks in Financial Market Operations had led to the establishment of an Assets and Liabilities Committee chaired by Mr Clementi, and the Risk Analysis and

Monitoring Unit. There was also an annual risk assessment exercise by management involving the Bank-wide Risk Matrix which was to be updated in 2000, as was usual each year.

Mr Buxton noted that while the paper said that Turnbull was discussed in the Audit Committee it was in fact a preliminary discussion which led to a decision to go straight to Court because the issues involved all Members of Court.

The Governor said that he took the sense of the Audit Committee to be that the Bank was going in the right direction. Dame Sheila Masters asked whether the Audit Committee would be looking at the updating of the Risk Map or whether the results would be put straight to Court. Mr Buxton said he suspected that the Audit Committee would wish to filter that issue. Mrs Heaton said that at companies where she had been chairing the audit committees, she had been asked to look at the risk management processes, while judgement of the nature of the risks and whether they were appropriate to the company had been reserved to the Board. She hoped that would happen at the Bank. The issue was whether the risk management processes would lead to the right information going to Court. Sir Chips Keswick said Turnbull had gone almost too far and become dangerous. It was not possible for every non-executive director to sign up to an assessment of all the risks. They should instead concentrate on whether the company met best practice in risk management. Mr Neill said that this view did not accord with his experience of the work his company had done on Turnbull, which had been very beneficial. By ensuring that the risk matrices and the underlying risk management processes were sound, it was possible to receive comfort that management was analysing and running the business appropriately. Court could still make those judgements. That did not imply that the Board of a company should satisfy itself in detail about the processes.

Mr Davies noted that the FSA's new legislation required it to regulate in a way that recognised fully the responsibilities of senior management. It had therefore set out its expectations of senior management of financial institutions, and had had to map that against Turnbull, and ensure that particular characteristics of financial institutions were aligned with corporate governance good practice. There was no requirement for the Bank to follow the FSA guidelines because it was exempt from the Financial Services legislation. But he believed that what the Bank was describing mapped against the FSA's guidelines and asked whether the Bank had looked at them. Mr Butler said he had not looked at the consultative document from the FSA but he had spoken to some of the supervisors about Turnbull. He believed that what the Bank was proposing mapped quite well against the principles set out in the FSA document but it was worth looking at again. Mr Davies suggested that it might be helpful if the Bank were able to say that it had considered the FSA's consultative document in formulating its procedures. The Governor agreed.

Format for this Year's Annual Report
(Executive Directors and Mr Footman in attendance)

Mr Footman said that the Bank was proposing an Annual Report similar to last year. There was one obvious change in that the report of Members of Court would be shortened and made simpler. It was intended to remain close to the principles of design developed last year, although there was an issue of photographs. It was proposed that photographs should only be taken of new Members of Court though an exception could be made for previous Members who particularly disliked their photographs. Court was content with the proposals.

SEALING COMMITTEE AUTHORISATIONS FOR INSPECTION
(Executive Directors in attendance)

In accordance with the terms of reference of the Sealing Committee, the record of authorities granted by the Sealing Committee was laid before Court for inspection.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues
(Executive Directors in attendance)

Mr Plenderleith reported that there had been a further gold auction in January, which was the fourth out of five during the financial year. It went well, with the price, at $289½, closely in line with the market. The cover of 4.3 indicated a good response. There were some encouraging signs that the gold market was becoming accustomed to the auction process. He noted that the discretionary approach to selling by the Dutch was achieving prices slightly lower than the Bank's. This encouraged the belief that the programme should be continued broadly in its present form; this was likely to be the outcome of the current review, being conducted with the Treasury, to decide on plans for the next year; the one question was whether there would be merit in auctioning smaller amounts more frequently. He noted that gold market conditions continued to be volatile, and a particular concern was the future of Ashanti.

Mr Plenderleith noted that the final phase of the transfer of functions from the Bank to the Debt Management Office was about to take place. Cash management, the financing of Government cash needs day-to-day, would be transferred on 1 April. There would be no significant impact on the Bank's operations other than to make them more straightforward.

Turning to the Business Process Review, Mr Plenderleith said Court was aware that the Bank had been conducting a review of processes in its banking business. The Bank had been taking steps year-by-year to cut costs, including the outsourcing of cheque processing, the end of banking in Branches, the shift of note distribution from Head Office to Debden and the internal reorganisation of settlements. The scope was diminishing for significant savings of that type, so it was necessary to look at the processes as a whole to see if further savings could be achieved that way. PA Consulting had been brought in to advise. The review had found that on top of its basic banking system the Bank had accumulated a variety of special systems to meet particular needs as they arose, such as TARGET, and the result was a fragmented set of systems with many manual interconnections between them. There was considerable scope for streamlining. The Bank would probably also move to a multi-disciplinary task force structure such as Registrar's employed. Investment cost was about £5.5mn, which was partly new software and partly the cost of making staff savings. When implemented in two to three years time, it could bring direct process costs down from £6mn by £1.5 - £2mn, ie a reduction of 25-30%. The exercise would not be a single project, but involve a reorganisation of processes, and initially reorganisation of staff. There was likely to be a reduction of 80-100 staff out of the total of 400, which implied that there would be redundancies over the period. The challenge was that the Bank would need staff who would eventually be redundant to help it implement the changes. The same challenge had been successfully met in the reorganisation of Registrar's and in the transfer of the CGMO to CREST. The Bank would report to Court on progress from time to time.

In reply to a question from Sir Chips Keswick, Mr Plenderleith said he was confident that the transfer of cash management would be achieved smoothly. He did not believe there would be conflict or confusion in the overnight market between the Bank and the DMO.

Mr Buxton asked for assurances that the review of business processes just ahead of a major review of IT systems would not lead to duplication. Mr Plenderleith said that the business process review was not principally an IT project, but a programme to restructure work processes as a whole; but the review would keep close to the IT review and ensure that there would be no conflict. Mr Buxton said the Audit Committee had the impression that IT improvements had been done piecemeal without linking them together, and it was hoping that there would be more linkage in the new IT plans. Dame Sheila Masters said that when doing an IT review it was not possible to stop doing everything else. The Governor commented that it was important to be aware of the IT review while conducting the business process review, and Mr Plenderleith said that this was the case. Mr Neill said it would be beneficial if Mr Plenderleith carried out the restructuring as quickly as possible.

Registrar's Department Report
(Executive Directors and Mr Sparkes in attendance)

Mr Sparkes said that the Department was achieving the agreed objectives, which were the same as those described last time he was at Court, in June 1998. It was meeting financial targets set by the Treasury of operating accounts for less than £4.30 each. That was despite a continuing decline of some 7-8% in the number of accounts, which was currently around 825,000. The decline was critical, because the target was not indexed. Thus Registrar's was having to make year-on-year productivity gains merely to 'stand still'. Commendable progress had been made in bedding in the new restructured Department together with a new computer system. It had also assimilated the National Savings Stock Register and was continuing to operate a postal brokerage service, though the number of applicants for this was continuing to decline and the number of sales was higher than purchases. This was not surprising because there was no governmental desire to market that service.

The main effort this year was work with CGO and CREST on the merger of the CGO settlement system into CREST. Mr Sparkes drew Court's attention to paragraph 10 of his paper describing the next phase, which was to move to "Electronic Transfer of Title". This had led to an on-going debate with the DTI and the Treasury about the apportionment of responsibilities. He noted that the CGO/CREST merger was still on course and Registrar's was still on course to achieve its interface to the merged system on 3 July.

Mr Sparkes said that Registrar's had set up a Business Improvement Group this year, as described in his paper. The main problem the Department faced was the continuing decline in account numbers and the volume of work. Thus, it was necessary to continue looking for improvements in service delivery and cost. If Registrar's was to achieve its cost targets it had to continue releasing staff. About 8-10 were expected to go in the year. Registrar's was having to focus strategically on the viability of the operation. A paper had been produced internally on how the Department might go forward in the future. Before moving on to that possible strategic change of direction, Registrar's was looking hard at improving the service by reducing costs. Mr Sparkes also drew attention to the comments in the paper about the reduction in the number of senior and line managers. The Governor thanked Mr Sparkes for doing a good job in very difficult circumstances.

Sir David Cooksey endorsed the comment and said the paper was very commendable. His only disappointment was that the efficiency drive had started with the Treasury saying it could get the service cheaper elsewhere. The target of £4.30 had been set over five years but the problem was that the competition was also moving ahead and he saw no benchmarking in the paper. Five years went quite quickly, and he asked what the target would be at the end of the fifth year. Mr Sparkes said that Registrar's had focused on that issue. An amount considerably under £4.00 should be the starting position. Registrar's was looking at ways of re-introducing economies of scale, either increasing the amount of the same or similar work, or other alternatives. It recognised that £4.30 was not good enough.

Mr Neill congratulated Registrar's on the improvement. He noted that businesses such as Registrar's should be able to make productivity gains of 10 or 15% a year. But award schemes were not the best way of encouraging that. In his experience there were better results from using productivity circles and similar techniques. Mr Sparkes said that Registrar's had used quality circles in the past and its new proposals were a variant. Mr Buxton said that the heart of the problem was that the business was well below the appropriate scale and would in future be more so. Mr Sparkes was doing a fantastically good job against the odds but in five years time the business would not exist. Mr Plenderleith said that an alternative would be to change the business, and the Bank had some good ideas. The Governor said these would be brought to Court when they were ready.

Executive Directors withdrew.

Remuneration Committee

Following a meeting of the Remuneration Committee earlier that morning, Sir David Cooksey proposed:

1. Professor Stephen Nickell would join as an MPC member on 1 June, and would be working four days a week. The Committee proposed to pay him 4/5ths of the basic rate that has been established for external MPC members. That basic rate was now £131,329, so Professor Nickell would be paid £105,064. As with the others, he would not join the Bank pension scheme but the Bank would pay 15% of his salary towards his own pension arrangements.

2. The four Executive Directors, like the rest of the staff, were to transfer to the new benefit scheme. Court had agreed last the previous month to a 2% across-the-board increase in pensionable pay for those going into the new benefit arrangements and the Committee proposed that this should also be paid to the Executive Directors with effect from 1 April. (Governors, Advisers and MPC externals were not going into Benefit*Select* so the issue did not arise for them.)

Court was content with the proposals.

Sheila V Masters
15 March 2000

Peter Rodgers
15.3.00

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 MARCH 2000

Present:

The Rt Hon.Eddie George, Governor

Mr Clementi, Deputy Governor - Financial Stability

Mr King, Deputy Governor - Monetary Policy

Dame Sheila Masters, Chairman, Sub-Committee of Directors

Mr Buxton

Mr Davies

Sir Ian Gibson

Mrs Heaton

Sir Chips Keswick

Ms McKechnie

Mr Morris

Mr Neill

Sir Neville Simms

Mr Stretton

Absent:

Mr Allsopp
Mr Bailie
Sir David Cooksey
Mr Hawker
Ms Kathleen O'Donovan

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

MONETARY STABILITY ISSUES

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

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Mr Vickers, in presenting the monthly MPC Report to Court, said that the previous Court meeting had been prior to the release of the February Inflation Report. He outlined the broad themes of the Report and its forecasts. The basic message was one of steady growth with stable inflation. The forecasts shown in Charts 1 and 2 on page iii of the Report showed that the best collective judgement of the MPC was for annual GDP growth to slow to around 2.5% over the forecast horizon; and for the annual inflation rate to fall below 2% for a period before rising to around target two years ahead.

Within this broad picture, Mr Vickers said that the imbalance between different sectors had narrowed over the second half of 1999. Both manufacturing output and exports had been rising. However, there was now a concern that the strength of sterling would lead to an increased imbalance between domestic demand and net trade looking ahead. The Report made clear that there were different views within the Committee about the central projection for inflation, primarily relating to judgements about the exchange rate and margins. These were outlined in Table 6B on page 57 of the February Inflation Report. The MPC had voted to leave the Bank's official interest rate unchanged at 6% in March.

The latest data suggested a continuation of recent trends. On the international front, Mr Vickers noted that US GDP growth had remained strong with the 1999 Q4 growth figure revised up 0.3pp to 1.7% compared with the previous quarter, to stand 4.5% higher than a year earlier. US non-farm business labour productivity growth was revised up 0.3pp to 1.5% in 1999 Q4, the highest quarterly rate since 1992 Q4. The euro-area showed a continued recovery, with quarterly GDP growth of 0.9% in 1999 Q4 to bring annual growth to 2.2% in 1999 as a whole. However, there had been a rise in annual consumer price inflation to 2% in January (up from 1.7% in December). Rising oil prices were evidently a factor behind this rise. Japanese GDP fell by 1.4% in Q4, a much sharper contraction than envisaged in the February Inflation Report forecast. Only private non-residential investment had risen over the quarter. Mr Vickers noted that it tended to be difficult interpreting quarterly Japanese GDP data.

Turning to domestic activity, the pattern of demand in 1999 Q4 was now clearer following the latest GDP release. Quarterly GDP growth remained at 0.8%, but annual growth was revised up to 2.9% (from 2.7%) due to revisions to earlier quarters. Looking at the components of total demand, Mr Vickers said final domestic demand remained around 4% higher than a year earlier, but had possibly declined over the second half of the year. It was difficult to interpret this, particularly given the possible effects on demand running up to the year-end, and the specific factors impacting on spending on cars. The contribution to quarterly GDP growth from net trade had been weaker than expected in 1999 Q4 (-1.2 percentage points) which emphasised the imbalance between domestic and external demand. Offsetting this, the contribution from stockbuilding had been greater than expected. The picture would clarify further with the release of full National Accounts data for 1999 Q4 on 27 March.

Mr Vickers said that information for the first quarter of the current year tended to support the expectation that imbalances within the economy would widen rather than narrow. Industrial production had fallen by 0.1% in January (-0.4% in manufacturing) after a 0.5% fall in December. This may have been Y2K-related but that was not certain. Retail sales had been strong in January, rising by 5.3% over the latest three months compared with the same period a year ago. Housing market indicators had been mixed but fewer loan approvals might be an early sign of the market cooling. Money and credit data were also mixed with total M4 growth remaining low but credit growth still relatively strong.

The recent crop of surveys continued to show contrasts between the manufacturing and other sectors on the one hand, and rising costs and stable prices on the other. These were both themes of the current conjuncture.

Mr Vickers then reported the latest labour market data which had been released earlier in the day. Annual headline earnings growth had increased to 5.9% in January, from 5.5% in December. The annual rate in January was 6.4% All private sector components of the series recorded strong growth with the annual headline growth rate for private sector earnings at 6.3% in January. Employment on the LFS measure rose further in January by 83,000, though hours worked had fallen. Unemployment had increased by 21,000 in January, although on the claimant count measure it had fallen 6,700 in February.

Turning to costs and prices, Mr Vickers said the overall picture was one of benign prices and rising costs. Producer output price inflation remained subdued: annual PPIY inflation stood at 1.6% in February (from 1.7% in January). But input prices had risen by 3.1% in February to stand 14.5% higher than a year earlier. A large part of this rise reflected higher oil prices which had risen further, from around $28 per barrel at the time of the previous Court to $29-$30 presently. There was no new consumer price data available since the previous meeting. House price inflation appeared to be moderating slightly, though it remained high.

Mr Plenderleith highlighted the main financial market developments over the month. He said the picture was a familiar one with sterling remaining high against the euro; markets anticipating a further gradual tightening in monetary policy; and equity markets continuing to rise overall. Within the foreign exchange market, the main point was the yen's strengthening vis-a-vis the dollar, to around yen 105/106. This may have been a reflection in part of the Japanese current account surplus, and it may also have been driven in part by end-year repatriation of funds into Japan. Whatever the cause, the appreciation was not helpful to domestic economic recovery and the Bank of Japan had been intervening in the market to resist the rise. Within the equity market, Mr Plenderleith said that there had been some change in the character of gains over the month. The Dow Jones Index had fallen quite substantially from its 1999 peak . This was largely the result of falls in mainstream stock valuations. But this had been more than offset by increases in technology and 'dot-com' stock prices reflected in the increase in the NASDAQ index. Mr Plenderleith noted that it was interesting that the decline in mainstream stock prices had not so far seemed to cause adverse side-effects in other markets.

Commenting on the situation in the construction sector, Sir Neville Simms said that activity remained at high levels but orders were still falling relative to a year earlier. Sir Neville reminded Court that the relationship between orders and activity was not straightfoward. Nonetheless, he was now more worried that there were indications that the market was doing something more than simply coming off-the-boil. He added that pay increases in the sector were high, particularly in certain pockets. For example, bricklayers in London and the south-east of England had seen wage rates rise by around 30%. Construction output was now almost as high as its previous peak but the industry employed almost a quarter fewer people compared with the late 1980s. Sir Neville also drew Court's attention to the Agents' Summary of Business Conditions, published with the February Inflation Report. He said the summary points made on skill shortages seemed inconsistent with evidence presented in the main text on employment. Overall, he said confidence in the construction sector remained reasonably positive but he felt a further quarter of falling orders might start to raise concerns.

Sir Ian Gibson said he expected the UK car market to remain very uncertain throughout the first half of the year. Car manufacturers were intervening heavily in the market – boosting fleet and rental sales - to maintain volume growth. But margins were consequently being squeezed. Imported models were driving sales growth where the benefits of sterling's appreciation were allowing manufacturers flexibility in pricing. Sir Ian noted that the German car market had recorded falling sales for the third consecutive month which was unexpected. The reason for this was unclear but it was driving more vehicles into the UK market. The Japanese market remained flat.

The outlook for vehicle production in the UK was not positive. Aside from Rover, Ford were unlikely to produce the next Fiesta in the UK. This would not become a reality for a few years but combined with Rover, this would have a major impact on the vehicle components sector, centred on the West Midlands.

Mr Neill said that the 'rip-off' Britain campaign had further irritated car manufacturers and was impacting on decision making. He said that manufacturing process time in the UK compared well with Japanese standards. But the problem was that costs were now some 20-30% higher. The impact on profitability and sourcing was evident. With Rover and Ford reducing their UK presence, the component industry could lose volume to a critical extent. This would not have an instant effect but, within two years, the viability of many companies might be questioned. Mr Neill said the UK-based Japanese manufacturers were being unusually vocal about the strength of sterling and the impact on investment in the UK. Sir Ian Gibson said the situation in the industry raised current account issues as volume production contracted.

Mr Buxton said that consumer borrowing continued to grow strongly. The housing market was now causing some concern in relation to lending ratios. Household borrowing as a proportion of earnings might be becoming unsustainable in some areas, notably London and south-east England. The ability to pay was no longer at favourable levels as interest rates rose. Lenders in the retail market might start to face problems, though he felt this was likely to be sectoral rather than a general cyclical issue. He said corporate borrowing conditions remained favourable. The Bank's Agents had said business confidence was rising but he felt the picture was mixed and probably more downbeat amongst smaller companies. In general, the corporate sector was relatively benign. The principal concern was the retail sector.

Ms McKechnie questioned the extent to which the 'rip-off' Britain headlines had impacted on manufacturers' plans. She said the key issue was the exchange rate for companies such as Nissan. She also said that the Consumers Association had never used the term 'rip-off' in a general sense, but rather had aimed that specifically at the car market. The situation in the food retailing sector was complex and not equivalent to car distribution and pricing.

Mr Morris said that the car industry faced a more fundamental problem than that of price. The main issue was overcapacity across Europe. He said the changes at the Dagenham plant were just a preview of forthcoming changes across Ford's European operations. However, because the UK had the additional problem of the exchange rate, manufacturers were looking at UK operations as a focus for a shake-out of capacity. Added to this, the social cost of shedding labour was lower in the UK than in other European countries, adding to the extent to which UK operations would bear the burden of over-capacity. Mr Morris also referred to the textile sector which had been greatly damaged by the strength of sterling. The trend towards increased sourcing abroad would continue and the worst was still to come. The Governor said the dilemma was finding a UK solution to a euro problem.

Dr Wadhwani asked Court to comment on the average earnings data, and to what extent the rise in earnings growth might by related to Millennium effects or underlying pressures in the labour market. He asked to what extent earnings were reflecting past profits and whether this would impact on prices to a lesser degree as a result. Mr Neill said competitive pressures meant overall payroll pressures were not increasing. Indeed, he said, some were moderating. Some sectors were witnessing large pay increases in order to attract staff. He said he doubted much impact on prices when other factors, such as the development of e-commerce, were tending to reduce costs to offset higher wage bills. He felt if e-commerce tools were adopted widely across business, the effects on costs could be large.

Sir Neville Simms said pay increases in the construction sector were running at a rate of around twice that of the RPI. In his own company's case, pay was budgeted to drift around 1-1.5% above the recent settlement of 3.5%. He said bonuses for the Millennium period were only now being paid.

Mr Davies said bonuses for the Millennium period in the financial sector were not a significant factor when viewed in the context of overall bonuses in a good year for many institutions. Settlements varied with lower paid staff securing increases of around 4-5% and professional and senior staff around 6-8%. Mr Stretton said barriers to entry in retail financial services were now low. This meant wages were being driven up to attract staff to new operations.

Sir Chips Keswick questioned the extent to which the US economy was vulnerable to a fall in high-technology stocks. He did not believe a sharp fall in the NASDAQ index would cause a sharp turnaround in US growth. He added that UK engineering orders were not dependent on US demand remaining strong. The recovery in the Far East had become an important component in the overall picture.

MPC Procedures – peer review comments on pre-MPC process
(Messrs Vickers, Plenderleith and Footman together with Dr Wadhwani in attendance)

In presenting a paper summarising the views of non-Bank visitors attending pre-MPC meetings over the last year, Mr King said that he thought the peer review would be a useful input into this year's Annual Report process. Requesting feedback from outside visitors was now a standard part of pre-MPC procedures. He said that there was a risk that the information received was selective. Nonetheless, the Bank had received letters from most visitors attending pre-MPC in 1999 and January 2000. Much of the feedback was very complimentary. One of the main questions raised was whether the amount of information presented at the meeting could be fully absorbed by the MPC.

Ms McKechnie noted that there was some criticism of the usefulness of survey and anecdotal information provided for the pre-MPC meeting. Mr King said he felt there was a very well defined role for the intelligence provided by the Bank's Agencies. The Agents themselves were experienced and senior people who were able, where necessary, to filter the information they received so that it gave the MPC a structured and accurate guide to economic and business conditions around the UK. The relationship between Agents and their contacts was interactive and the quality of information received tended to improve as relationships developed. In addition, each month the MPC itself was involved in setting questions for the Agents to put to contacts covering issues of particular interest to the Committee.

In relation to survey information, Mr King said the MPC found the quantitative results from the various surveys very useful. What was less useful was the interpretation often accompanying surveys from sponsoring organisations such as the British Retail Consortium.

Dame Sheila Masters said not all attendees had responded and asked if there were reasons for this. Mr King said he was not surprised that Chinese visitors had not responded. The ONS had attended pre-MPC on two occasions and had responded in detail once.

Sir Neville Simms said the responses were interesting to read. Overall, the feedback was glowing. There were some very constructive detailed points which he thought might be useful for the process. Mr King said some of the detailed suggestions had already been adopted. He said there was one theme in the feedback – the apparent lack of integration of the pre-MPC meeting into the MPC forecast which probably reflected a lack of understanding amongst visitors of the broader MPC process. Similarly, he felt there was some misunderstanding about the links between the MPC Charts and Tables pack and pre-MPC. The data pack was not intended to be studied at pre-MPC.

Mr Buxton said there was a great amount of complimentary comment about Bank staff and the quality of the presentations and analysis which, he hoped, was relayed back to those areas involved. He also noted that the ONS had been surprised at the way their data was used by the MPC. Mr King explained that the attendance of the ONS at pre-MPC was part of a considerable effort to maintain a very close relationship with them. This on-going liaison, which included regular meetings between ONS and Bank staff, was formalised in the annual ONS priorities exercise which allowed the MPC to state the areas where it would like to see improvements in the statistics provided by the ONS.

FINANCIAL STABILITY ISSUES

Domestic Developments and International Issues
(Messrs Tucker, Vickers and Plenderleith in attendance)

In the absence of Mr Clark, the Governor invited Mr Tucker, Deputy Director (Financial Stability), to bring Court up to date with developments in the FS area. Mr Tucker said that the main domestic item of interest at present was the forthcoming publication of the Cruickshank review of competition in banking. There were likely to be recommendations about payment system competition, but which might have implications for the Bank's payment system oversight role. He reminded Court that the business aims established for the Financial Stability area of the Bank included increasing its work on, and oversight of, payment systems and associated systemic risk issues. Mr Tucker said that the Bank's work might need to be looked at in the light of the Cruickshank report and any subsequent developments.

Turning to international issues, Mr Tucker said that a large amount of work was coming to a head for the forthcoming IMF, G20 Deputies and Financial Stability Forum (FSF) meetings in the Spring, the latter two due to be attended by Mr Clark. The FSF meeting would bring together a range of key bodies including the IMF, World Bank, G7 Finance Ministers, central banks and regulators (including the FSA).

Of the many items on the agenda, Mr Tucker picked out three. First, the Forum would be considering a review of the risks associated with capital flows and, in particular, their volatility. Mr Tucker said that one of the major lessons from the Asian financial crises was that countries could suffer from liquidity crises and so needed to control their external foreign exchange liquidity risks. Surprisingly, this had not been included in the 35 areas of work identified by the G7 Finance Ministers in 1998 in response to the Asian crisis. The Bank and others had for some time been keen to place the issue of country liquidity risk on the agenda for international discussion. The US Federal Reserve and the US Treasury had reached the same view.
Mr Tucker said the main audiences included national authorities and banking regulators in emerging market countries, where it was felt the issue of bank liquidity risk needed to be considered alongside capital adequacy. The other main audience was the IMF, to encourage it to develop a greater surveillance capability to monitor the build-up of exposure to liquidity risk.

Second, the Forum would consider a review of codes and standards, which Mr Clark had discussed at the previous Court meeting. The main issue under consideration was implementation of codes and standards where initially effort was being concentrated on around a dozen codes. Mr Tucker said that it was apparent from discussion that there would be little "hard-wiring" from standards to, for example, Basel Accord capital weights. Another area under consideration was whether reports on countries' compliance with codes and standards should be published. This was a contentious issue between the G7/G10 and emerging market countries, many of whom seemed to have a preference to monitor themselves. This issue was likely to feature prominently at the G20 Deputies meeting.

A third report, of a group chaired by Howard Davies, addressed highly leveraged institutions. Direct regulation and an international credit register were rejected, at least for the time being. There was an emphasis on disclosure, with for example legislative measures being taken in the US. There were also calls for enhanced surveillance of over-the-counter derivatives and foreign exchange markets, which the Bank would need to take account of in its own market surveillance work. Quite separately, guidelines for conduct in these markets were being considered with a view to ensuring hedge funds were less able collectively to "gang-up" on countries, which was a concern in Australia, Hong Kong and others. The Bank was involved in these discussions though was somewhat sceptical of this line of thinking.

Finally, Mr Tucker mentioned that the other issue relevant to the IMF and World Bank Spring meetings related to private sector involvement in financial crisis resolution. There had been relatively limited progress here compared with other areas of the international financial architecture debate. A small initiative that had progressed concerned collective action clauses in sovereign and emerging market bond contracts. This would help with the management of crises at the margin but was not a major change in itself.

Mr Buxton commented that he felt the Bank was bound to be drawn into the discussion that would follow the Cruickshank report, in particular about payment systems. He added that he was surprised that liquidity risk had not been debated more in the context of the Asian financial crisis. He said no country could stand up to the massive flows of money in world financial markets. The effects of these flows were largely seen in the foreign exchange markets. But when countries did not have sound financial systems and credibility – for example, Indonesia – liquidity problems were likely to result. The Governor said that the emphasis of the Cruickshank review in relation to payment systems was on access and competition, and the Bank had an interest in this. Whatever the proposals, the issue of needing to reconcile and balance the objectives of competition and risk oversight of payment systems would remain. Sir Chips Keswick added that transparency was fine in principle. But there was an issue where the consequence was that financial systems were viewed as transparently weak. In this sense, transparency had to be part of wider improvements to financial architecture and regulation.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues
(Messrs Plenderleith and Vickers in attendance)

Mr Plenderleith said there were three developments that he wanted to draw to the attention of Court. First, commenting on the eligible bills framework, he said that there would shortly be an announcement about changes to the requirements for issuing eligible commercial bills. These were essentially technical in nature and sought to update certain requirements which had their foundations in the 19th century when commercial bills were issued to finance 'real' trade. The effect would be to liberalise the use of bills, allowing greater use of them by companies in meeting short-term financing requirements.

Second, Mr Plenderleith said HM Treasury had announced the programme of gold auctions for the financial year 2000/01, to continue the planned sale of gold announced in May 1999. The programme would replicate this year's programme and be on the same basis, with the aim of selling around 25 tonnes at each auction. He said the market had become comfortable with auctions and there was no good reason to change the programme at this stage.

Third, Mr Plenderleith explained the plan for the Bank to take over from HM Treasury the issuance of euro-denominated 3-year notes, with effect from January 2001. Court had a paper explaining the proposal. The Treasury had decided to end their programme in order to issue gilts, which would be swapped into euros. He said this was aimed at addressing the relative shortage of gilts which was currently distorting the market.

The Bank believed that it was useful to retain an official UK presence in this area of the euro markets to continue to encourage trading in euro denominated paper in London. Terminating the programme would be unfortunate. It was a cost effective option for the Bank and the existing programme had been profitable. As a result of the Bank becoming the issuer, the notes would move onto its balance sheet. Mr Plenderleith said he estimated that the balance sheet would ultimately increase by some £4 billion. This would not involve any currency risk and effectively no interest rate risk. It would involve a sovereign risk but in an asset class where the Bank already had an exposure (as it already took euro-denominated bonds as collateral in its open market operations). As the programme would be expected to be profitable, it should add to the Bank's income. Mr Plenderleith said the overall rationale was, however, to ensure a continuing presence in this euro market.

In relation to the change in the framework for eligible bills, Sir Chips Keswick asked if there was a system for monitoring the scale on which bills were being drawn, because an increase in eligible bills could be a source of pressure on sterling. Mr Plenderleith said that this had been a concern in the past, but in the current-day deregulated markets bills were much less likely to be a specific source of pressure on sterling. However, statistics for the size of eligible bills in issue were collected and monitored.

The Governor requested that Court should give its contingent authority to the changes, subject to further GOVCO review; he said that in the event of HM Treasury choosing to announce the changes rapidly, the Bank would want to avoid an awkward hiatus. Court AGREED.

EXECUTIVE REPORT
(Messrs Vickers and Plenderleith in attendance)

The Governor noted that the Bank had explored the question of holding Court in Leeds in January 2001. This was not ideal for all Members of Court but on further enquiry it had been found that it would be very difficult to organise for October 2000. With Court's agreement the Bank would like to go ahead with Leeds in January but it had taken on board the point about the desirability of October. Looking forward, he envisaged that Court would take place in Cardiff in October 2001, subject to an investigation of the practicalities, and the Bank would then meet outside London in October in each subsequent year.

Turning to the Benefits Review, Mr Clementi said that at the February meeting of Court he had noted that the Union vote had been against the benefits proposals in Head Office, but the Bank had invited staff to sign individually by 24 February. By that time more than 90% had signed, and since then the total had risen to more than 99%. By the Court meeting, only 14 staff had failed to sign and he believed this would fall further by 1 April. The Bank would have to decide how to deal with those who had not signed. It was right to enquire carefully into their individual positions. He noted the sensitivity of the situation, in that the Union was still talking about a possible class action against the Bank. The Union was unhappy that the Bank had gone over its head and was keen to have its day in court. However, in summary, the main issues were largely behind the Bank. The majority of staff appeared content with the new scheme. But as regards the few remaining cases there was still work to do, and he could not absolutely rule out that the Bank would be drawn into a tribunal case.

Turning to the IT review, he said that the proposals had been agreed in December and the terms of reference had been shown to Court in January. A beauty contest had been held and OCP, a firm known to the Bank, had been selected. OCP was working on a project for MA, so they had some knowledge of the Bank of England, and certainly of its newer, growing parts. He hoped to bring the report to a full meeting of Court in the summer. It would be useful if beforehand the consultants could talk to one or two Members of Court. Mr Neill had kindly agreed, and it was hoped that Mr Buxton would also talk to them.

Mr Morris said he supported the package, the methodology and all the reasons were very clear for proceeding with *BenefitSelect*. He noted that the change had been a shock to the system of many people and he asked whether the Bank believed it worth considering how the damaged relationship with staff could be repaired and how morale could be lifted again. The follow-through was as important as the decision taken to implement the package. The Governor agreed but said the Bank had, however, listened very carefully to the points made by staff as it had gone through the process, and he believed they had been addressed fully. The Bank had been able to persuade most people who took professional advice that *BenefitSelect* did not disadvantage anybody. Notwithstanding that, he acknowledged the difficulty for morale and said he would very much welcome any thoughts Members of Court had about how to address that. These should be sent to Mr Footman or Mr Clementi.

Mr Clementi said he understood the points Mr Morris had made, and to some extent sympathised with them. However, in relation to the difficulties with morale, he noted that there were two areas with substantial downsizing to come. Property Services had another year of reductions ahead and Banking Services had just started its review and it was known by staff that this was likely to lead to redundancies. One of the reasons for the difficulty with *BenefitSelect* was that a number of people wanted to take benefits into retirement in this redundancy context. This was one reason why it had been decided that those leaving the Bank over the next 12 months could take some of their existing benefits. He believed there would be a difficult 12 months or so until it was possible to say the Bank was the size that was appropriate to all the changes made in 1997-98. This situation had not been reached yet.

Mr Neill said he was not surprised that, at 24 February, 90% had signed. The normal distribution of acceptances in such situations was that 10% of the staff would give total support to a change, 10% would resist everything and the rest were the silent majority. The danger was that if too much attention were given to those who resisted, the silent majority might think that that was the way to get noticed. He said the appropriate solution was to offer the 10% who resisted an easy and early exit from the business.

MANAGEMENT OF THE BANK

Finance

Payment to HMT in lieu of dividend
(Messrs Plenderleith, Vickers and Midgley in attendance)

Mr Clementi noted that under the basic arrangement with HM Treasury the dividend would be 50% of profits. It was estimated that the total to February 2000 would be £48.3mn, which would be finalised when the accounts were settled at Court in May. In the meantime he proposed that the Treasury be paid an interim dividend. Court AGREED that pursuant to Section 1 of the Bank of England Act 1946, and Section 8 of the Bank of England Act 1998, an interim payment of £24.15mn, be paid to HMT, in lieu of dividend, on Wednesday 5 April.

Other items

Annual Report
(i) Draft Review of performance against objectives and strategy
(ii) Draft Report on MPC Processes
(Messrs Vickers, Footman and Midgley in attendance)

Mr Footman introduced Sections 4 and 5 of the Annual Report which he noted were relevant to NedCo's part of the Annual Report. He said the question was whether there was sufficient material to enable NedCo to publish the kind of review it made of the Bank last year, or whether there were matters of substance NedCo would want to put into its own report directly. Did the drafts contain the right facts and was Court comfortable with the judgements that had been made? Mr Footman noted that Members of Court had the traffic lights document in their papers, which was not for publication, but it would be Court's collateral for the text of the Annual Report.

Ms McKechnie noted the wide range of views about whether money had been wasted or well spent over the Year 2000 issue and asked whether it was appropriate to make such a firm judgement that it had been well spent on page 22 of the Section 4 draft. The Governor said that in working through the process leading up to Year 2000, which was initially a technical analysis, it became apparent that technical questions were not going to be the major problem. Rather, the main difficulty was a psychological one. If the Bank had not persuaded the financial system and the public that it had adequately anticipated any difficulties by demonstrating what it had actually done, the potential psychological damage and the accompanying headlines would have been serious. That could have led to real problems. He noted this issue was discussed at Court in Birmingham last May. It was the psychological problem and the measures taken to counter it that had led to the adamant expression of the point on page 22. Mr Neill said he agreed. It had been very important to get confidence into the market. In his company, some minor things had gone wrong but he believed that if the preparatory measures had not been taken there could have been very serious problems. Dame Sheila Masters said most companies had had a substantial programme of remediation and many had also upgraded their systems at the same time, which led to some confusion between the two. There had been some unfair media speculation that because there was no crisis the money had been wasted.

Mr Morris, in a general comment about the two sections, said the storylines were: whether or not there were sufficient resources for the MPC; the reference to some of the tools for policymaking such as opinion polls, which could lead to requests to publish the full data; the Year 2000 issue; EMU preparations where there was sensitivity to how they were handled and expressed; and the reference on page 4 of Section 4 to research to support monetary policy in the future being held back. Because of the sensitivity of these points he wished to flag them up in case Court wished to look again at the drafting.

Returning to the Year 2000 question, Mr Buxton said he agreed that the money was well spent. But Mr Davies said he agreed with Ms McKechnie. He did not see why that section should begin by attacking those who believed the preparations had perhaps been excessive, and he suggested dropping the first sentence of the first paragraph on page 22. He believed this had gone a little too far. The Governor agreed that that part of the paragraph should be omitted. Sir Chips Keswick asked why there was such a fuss about what had been spent, when the Bank had a budget which it did not exceed.

Sir Neville Simms said he was cautious about putting the resource issue in Monetary Analysis into the Annual Report a year on, which he saw as self flagellation. He suspected the Bank might be saying that because it wanted the Government to untie the purse strings to pay for more. He asked whether it was the moment for the Bank to criticise itself, especially as the issue was raised twice in the draft sections. He noted that it was management's job to obtain the resources required. Dame Sheila said the purpose of the Annual Report was to offer an honest appraisal and not just to spin. Sir Neville Simms said there was a difference between positively spinning a point and omitting a point. As Non-Executive Directors, they might well offer criticisms on the resources issue. Dame Sheila said that the Non-Executive Directors had agreed initially that they would look to the inclusion of substantive points in Sections 4 and 5, written by the Bank. Sir Neville said he still believed that on reading the passages now they appeared a bit heavy-handed. The Governor said the drafting could be looked at.

Mr King noted the significance of the fact that the comments were in bold. Either they should not be in bold or the drafting should be looked at again to ensure there was a clear judgement of whether the objectives had been achieved. In reply to a question from Dame Sheila, Mr Footman said that the passage in relation to the target could return to the words used a year ago, which were that inflation had remained close to the 2½% target.

Turning to MPC resources, Dame Sheila said this was a thorny issue. She noted that Non-Executive Directors had received a letter from the Governor giving the MPC's collective response to the six key questions. On the resources issue, the reply said the jury was out, and she believed that some sense of that reply should go into the Annual Report. The Bank should not be giving the impression to the outside world that it was all done and dusted. Something should be inserted that said that the issue was being kept under review. The issue might erupt again during the year and it might appear foolish if it were not recognised that it was something which had to be continuously worked at. Mr Morris said the Annual Report was a historical document. There was an issue of where the line was drawn between detail and points of substance. The Report acknowledged that resources were an issue, but he asked whether it needed to be reported in detail. Dame Sheila said that the Treasury Committee was bound to ask. It would be easier to say what was thought about it in the Annual Report. Mr Morris asked to what extent Court would wish to pose the question of a new difficulty. Dame Sheila said that she believed that there should be some sense of the collective MPC response in the Report. Mr King said there could be one sentence saying it was too early to judge how well the arrangements would work, and Court would keep them under review. Dame Sheila agreed.

Ms McKechnie noted that Section 5 referred to non-executive members of the MPC, and she had thought that the term to be used was external member. Mr King said they were non-executive members of the Bank. Ms McKechnie asked why the MPC as a whole had not signed up to Section 5. Dame Sheila said that it was a Bank report. Ms McKechnie said external members were employed by the Bank and were not in the same role as Non-Executive Directors. The Governor agreed that the language would be looked at.

Sir Ian Gibson noted that the chairman of any company might well be asked on a resources issue what was going to be done about it in the following year. Part of the accompanying text written by the executive of a company would cover such issues. The Bank should be prepared and have ready a statement about how the objective would be met over the next year. Sir Ian said that he was referring to page 4 of Section 4. The Governor said the Bank would look into that point.

Mr Stretton said the sections were very long and written in a discursive rather than condensed style. It was not wise to make a rapid change from that. But he would be interested in having views on whether this was the long-term format Court wanted or whether there should be a shorter version. Companies would get the views of their customers about what they wanted to read. The Governor said that the Bank would perhaps reflect on that.

In reply to a question from Dame Sheila, Mr Footman said that the section on peer review would be inserted after the discussion at that morning's Court meeting. Mr King, referring to Mr Stretton's point, noted that there was much detail in Section 5. Dame Sheila said that this was partly necessary for accountability reasons, because it was a key explanatory document which was why it was difficult to cut, although some drafting changes might be possible. The Governor said he had sensed that Mr Stretton was referring particularly to Section 4.

Sir Ian Gibson noted the reference to the Service Level Agreement with the Office for National Statistics. He asked whether there was public access to that agreement. In response to a question from the Governor, Mr Vickers said he could not see any reason why it should not be public. The Governor said that this needed to be cleared with the ONS and the Bank would pursue that. Mr King said that there were two sorts of paper involved. With reference to the Service Level Agreement, there was no reason why it should not be published, perhaps on the internet. There were also comments in March on the priorities for statistics, and he expected questions on that from the Treasury Committee, which had raised the matter in the past. The Governor agreed with the suggestion by Mrs Heaton that the paragraph on regional information on page 7 of Section 5 should be shorter. Mr Neill praised the traffic lights document and said most companies would give their eye teeth to have green in so many boxes.

Court was up.

Sheila V Masters
19.iv.2000

Peter Rodgers
19.4.2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 APRIL 2000

Present:

The Rt. Hon. Eddie 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
Mrs Heaton
Ms McKechnie
Mr Morris
Mr Neill
Ms O'Donovan
Sir Neville Simms
Mr Stretton

Absent :

Mr Hawker
Sir Chips Keswick

The Governor welcomed Mr Don Kohn, from the Federal Reserve System, who had been invited to attend Court for the first part of the meeting covering Monetary Stability Issues, as part of the peer review of MPC's procedures.

On behalf of Court, he also congratulated Dame Sheila Masters on the recent announcement of her elevation to the peerage.

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

MONETARY STABILITY ISSUES

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

Introducing the monthly MPC Report to Court, Mr Vickers noted that the MPC had voted to leave rates unchanged in April by 6 to 3, with Mr King, Professor Buiter and Mr Vickers preferring a 0.25% increase. Turning to international data he noted that the FOMC had raised rates by 25 basis points to 6% on 21 March, since which date growth had been robust with retail sales up sharply year on year and price pressures rising. In the euro area, HICP rose to 2.1% in March and the ECB had crossed its upper reference limit for inflation for the first time. EU inflation rates varied from 0.7% in the UK to 5% in Ireland. Turning to 1999 fourth quarter GDP, Mr Vickers noted that growth remained at 0.8% with the balance changed slightly, as final domestic demand was higher but offset by lower inventories. Relative to previous estimates, final domestic demand was stronger and net trade remained a negative contribution. The preliminary estimate of GDP for 2000Q1 showed overall growth looking weaker than the previous quarter, with industrial production falling again in February and the same for manufacturing, though services were stronger. The retail sales trend looked firm while house prices were mixed. Surveys were also mixed.

Turning to the budget he said that cyclically adjusted borrowing would be lower than PBR in 2000/01 but looser by 2002/3. Spending increases from 2002 onwards were much bigger than PBR. Overall the underlying stance was tighter in 2000/1 but looser in 2002/3. The labour market showed headline earnings rising to 6% in February whilst 12 months earnings growth was 5.6%, not seasonally adjusted, of which 5.1% was for regular pay and 0.5% was the bonus contribution. This was the first month not affected by bonus discontinuity. The ILO unemployment measure was down 25,000, December to February, to 5.8% and employment was up by 59,000 over the same period. RPIX inflation fell to 2% in March. RPI rose to 2.6% and RPIY rose to 2.1%. Goods prices fell by 0.2% in the year to March while services inflation was unchanged.

Discussing the markets, Mr Plenderleith noted that there were considerable movements up and down but the end result since the last Court was not very different from where the markets had started. He drew Court's attention to chart 1, showing sterling, and chart 6, showing the equity markets, where there had been volatile movements. He noted that the FTSE was 12% less than the peak at the beginning of the year. That Dow Jones was 10% less and the NASDAQ was 25% less than in March. These were substantial adjustments but not crashes, and not hugely out of line with the adjustments people had expected to see in these markets, given the growth prospects.

Mr Buxton said consumer credit was still strong, growing at 11%, though this was down from 15%. The mortgage market had slowed a bit but was still quite strong. The picture for domestic demand was of still strong growth and a lot of spending. The question was whether the corporate environment would lead to a slowdown, though that was not happening at the moment.

Mr Neill said that the car market grew 8.6% in March and the first 10 days of April showed a 2% fall, with a fall for retail sales of 7.5%. He noted that Rover's market share had doubled and BMW's had halved. The overall figures might suggest that the industry was in quite good shape but the reality was that the forward intentions of all the major players were worrying. The sentiment in board rooms in Tokyo, Stuttgart and Detroit had progressively changed since BMW bought Rover so that the trend was to look outside the UK for future investment. Before BMW bought Rover, almost all had teams in the UK trying to source more components here, but within a few years it had changed to the point where they had teams trying to source away from the UK. These decisions would not be obvious until 18 months out, because they related to new models. He knew of three or four component manufacturers which had frozen decisions to build factories in the UK or stopped plans altogether. Three or four years ago, the emphasis had been on buying in the UK and helping component makers to improve their productivity, even if it meant paying a premium price. Now that had changed, and manufacturers were looking at the internet and buying in the lowest cost market in the world, regardless. It was a sea change in attitude, compounded by what BMW had done to Rover. The trends were worrying. One could suggest improving the productivity to compensate for the current strength of sterling. The truth was that the tools manufacturers were using were the ones Japan and the US had perfected years ago and they were still improving faster. The currency was clearly a very serious issue. Even the Japanese were more vocal now, with the exception of Honda, though they too were struggling. Mr Neill said he would be happy to go into more detail for the Bank.

Ms McKechnie said that the headline results of the consumer confidence monitor suggested that Mr Buxton's concerns were slightly misplaced. Every single indicator had fallen back to the levels of January 1999. Respondents were expecting higher interest rates and inflation rates. The survey was picking up early signs of caution, and changing attitudes.

Mr Bailie said that the single biggest problem in Northern Ireland was the exchange rate. At a micro level there were closures of shops and garages in particular, and heavy goods vehicles were operating from the South, with substantial savings. The political uncertainty was having less of an impact and businesses were getting used to it. In the Republic, inflation was 5% and rising and interest rates were totally inappropriate. There was a lot of labour mobility from North to South. He also noted a sharp increase in UK television advertising of 12% in the first quarter, largely driven by dot.com companies. In general, he had not seen evidence of people pulling out of the markets, because they were not giving up lightly having fought to get in to them.

Sir Neville Simms said that last month he had indicated quite a sharp drop in order intake for the construction industry but in fact it had picked up in the next quarter. There was a switch in spending towards the political end of the spectrum, covering health and education and he noted a really enormous pressure on the Government to do something on the transportation side. Those factors would keep the market growing overall. London and the South East were the only places where labour was a major issue. However signs of labour market pressure were appearing elsewhere in the country whenever a large project was started. The industry stayed busy, with a change of balance in the type of activity and increasing pressure nationally on wage levels.

Sir David Cooksey noted that the pharmaceutical industry was tending towards location of investment overseas, as well as the motor industry. It was sourcing more components and products overseas and beginning to move production off shore. Turning to asset price volatility, he said there had undoubtedly been a lot of rubbish floated under the banner of the internet over the last year and the market had been indiscriminate. It was uncomfortable, but what was happening was a move to more careful choices. This was healthy. He hoped the market would not, however, dry up entirely because of a lack of confidence. In the last three months, the venture capital community had virtually stopped backing internet commerce deals in the retail area because it was saturated, but business to business e-commerce had not stopped. A study a week before had shown that 70% of all e-commerce businesses at the retail end were likely to be bankrupt by the end of 2000.

In answer to a question from Mr Allsopp on structural imbalances in the UK economy and the exchange rate, Mr Vickers said he did not believe there was such a thing as a Bank staff view on all these questions. The Bank put a lot of work into trying to understand the relationship between sterling and the euro, but the puzzle remained. Dr Julius said there was no uniform MPC view. The sterling value was driven more by the euro and the dollar than by the fundamentals of the British economy, but the longer sterling remained at that level, the more real economy adjustment took place. The inflation target required the Monetary Policy Committee to take account of these imbalances. All members would wish for adjustments through the exchange but they still had to recognise that adjustment was partly through the current account and partly through the fact that inflation was less than the target, and had been so for 11 months. That in turn was partly because the Committee had not foreseen the trend for the pound. Mr Allsopp asked whether there should be worry about adjustment coming through the current account. At the current level of interest rates people were still willing to hold sterling and might not regard the UK and US current account deficits as being unsustainable. Mr King said that the pound had been strong against the euro but not against other currencies and had been remarkably stable against the dollar. It was a phenomenon of the euro not the pound. He did not share Dr Julius' view that the situation was sustainable. There was a large current account deficit, domestic demand was growing above sustainable rates, and large swathes of manufacturing were removing capital from the UK. In the long run, he expected sterling to adjust. In the UK economy, what was going on was not sustainable, but the inflation rate had been kept close to target. If the MPC had known what the exchange rate was going to do, its actions would have led to a significant overshoot. This was no comfort to those affected because it was outside their control but it was also outside the control of the MPC. The reasons were to be found on the Continent. The MPC had kept the overall economy roughly in balance but at the expense of imbalances within it. Mr King did not believe that was a sustainable position.

Mr Allsopp commented that the question of where the economy was heading in the long term was highly relevant to short term policy. Professor Buiter said that the US and UK situations were not sustainable. US demand had been allowed to grow out of control though it was not as bad as in the UK. But the exchange rate and current account were not sustainable. He did not know the causes of the exchange rate strengths but the MPC did know the consequences of the pound for the inflation target. It would welcome higher interest rates and a lower exchange rate but that was difficult to deliver. The Governor commented that the discussion in Court illustrated the real dilemma with which the MPC was confronted.

Work of the Agents
(Same attendees as for the previous item, together with Messrs Jenkinson, Iles, Webster and Ms Camper)

Introducing his paper, Mr Jenkinson said that the Agents continued to play a major role in briefing the MPC on business conditions and their profile continued to rise. The Agents' Quarterly Summary of Business Conditions was now published as part of the Inflation Report. He noted that members of the MPC had made more than sixty visits to the regions, hosted by Agents. The Agents were also playing a leading role in the new competition for schools. More generally, they provided valuable insights not otherwise available to the MPC, especially where economic developments were at odds with earlier expectations. The relationship between the Agents' assessment and subsequent trends in the data were generally relatively close but significant steps had been made to improve the contact base in recent years, though there was still further to go. Good contacts had been established with new English regional developments agencies which were formally launched last April. The Agents also maintained a watching brief on the development of regional investment funds.

Mr Clementi said that the Agents for the North East and the North West were directors of investment funds and in the North West the Bank was also a nominal guarantor (for ten pounds). He believed there should be a balanced position, with not too great an involvement with the financial backing of investment funds, but not too little, given the Bank's interest in small and medium enterprises. He drew attention to the proposed policy in this regard, set out on page 7 of Mr Jenkinson's note. Subject to the two existing situations, which would continue to the end of the respective terms, the Agents should not be directors or guarantors of investment funds but could be involved as observers, facilitators and helpers. That was the appropriate balance for a central bank.

Mrs Heaton agreed that it was a sensible approach. Dame Sheila Masters suggested that there could always be exceptions. She had been worried about the North West taking on risks, and it had not proved to be a problem. It was an example of where, without Bank support, progress would have been hindered. Mr Clementi said it was always possible for an Agent to come to Court to make a case for a particular area, but the intention was to establish a broad policy. The Governor said that the caveat was important and he agreed with Dame Sheila. As a general guideline, there would be active participation but not board or financial participation; but it should be made clear that if people wish to make a particular case it should be brought to Court. Sir David Cooksey commented that it was difficult to attract people onto such boards, and he endorsed the proposals and noted the importance of promoting Bank involvement to help funds get directors to come on board. The Governor agreed. Sir Ian Gibson agreed with Mr Clementi. It was important to be sure how this was communicated. He noted the possible difficulties if Wales or the Midlands, for example, noted the Bank's more direct involvement in the North East. It was better not to stray into the political arena. Court needed to be sure that the Government understood the position the Bank was taking so that a Secretary of State did not, for example, endorse some plea to the Bank that ate into the policy. The Governor said that he would write to Steven Byers and the Chancellor and make the Bank's policy clear.

Dame Sheila Masters said that she heard much praise of the Agents, and their role in communicating Monetary Policy had been very impressive. Mr Morris said he did not wish to dissent from anything said about the report. But he did not have a feel for how economic and business perceptions were behaving on a regional basis. At some point he would value being given an indication of the different regional aspects of behaviour. The Regional Development Authorities were being given more resources and responsibility and it would be important to know more about how the economy performed on a regional basis. The Governor noted that the Agents provided individual regional reports which Court did not see. He would discuss with the Bank executive whether it was appropriate from time to time for Court to see these regional reports. Mr Morris said it would be of benefit to see them at least on an informal basis. The Governor said he would discuss with the executive whether there were any reasons why they should not see the reports. Certainly in terms of statistical evidence he did not think there was any sensitivity. Mr Bailie said he spoke with Mr Falls quite frequently and he knew that his input to the MPC reflected regional problems correctly. The Governor said that he warmly appreciated Court's close contact with the Agents.

NON-POLICY MEETINGS OF THE MPC
(Messrs Vickers, Clark and Plenderleith and Professor Buiter, Drs Wadhwani and Julius and Mr Kohn in attendance)

Mr King presented the paper to Court. There were no comments.

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

Mr Clark said that the Financial Stability area would periodically produce a paper for Court on its activities. He noted the volatility of the markets, but also pointed out that the NASDAQ index was still 100% higher than a year ago and the Techmark index more than 50% higher. The levels were however less extreme now than a few weeks ago. He noted that half the valuation of NASDAQ was accounted for by firms that had never made a profit.

Turning to the paper before Court, he drew attention to Don Cruickshank's report and its coverage of payment systems and banking services for small firms. He noted that the Bank had a role, set out under the Memorandum of Understanding, in relation to payment systems, and that there were a number of points in the report where the Bank was doubtful about the facts or the analysis. Overall, it was important that whatever competition body was set up, it was done in a way that fitted with the Bank's oversight role as set out in the MOU, and that there was a satisfactory mechanism for resolving conflicts between competition and risk objectives. However, it seemed unlikely that legislation on payment systems would be in the next session of Parliament, and there were doubts even beyond that, though the Chancellor had said in the budget speech that he would legislate. Turning to small firms, Mr Clark noted that the area had been referred to the competition commission and the Bank had been asked to give evidence in the next month or so based on its work on small and medium enterprises.

In an apparent aside, Cruickshank had recommended that any lender of last resort action be disclosed by the Bank after a set period, of "say a year". The Bank was nervous about a fixed time scale and would rather follow the International Monetary Fund code which talked about the importance of transparency but only when the risks of precipitating a crisis through disclosure had passed. He noted that a recent IMF exercise had revealed that the Bank of England's approach was amongst the most transparent in the world.

Mr Clark also drew attention - among a large number of meetings with which the Financial Stability area had been involved since the last Court meeting - to the third meeting of the Financial Stability Forum, which he had attended along with Mr Davies. He noted that the forum, apart from a general review of vulnerabilities in the international financial system, which had focused heavily on equity market behaviour, had spent much of its time on three reports covering highly leveraged institutions, offshore centres and capital flows. On the first, prepared by a group under Mr Davies, the conclusion had been not to pursue the idea of direct regulation for the time being, but to hold it as an option in reserve. On the second, a list of "uncooperative" offshore centres would be published within a couple of months, And on the third, there was a sense that emerging economies and perhaps all economies would benefit from more attention to their external balance sheets as a whole, and particularly currency and maturity mismatches in their external assets and liabilities.

In response to a question from Ms McKechnie about whether the Bank would publish its responses to the Cruickshank Report or deal directly with the Treasury about the issues, Mr Clark said that, in relation to small firms, the Bank would put a formal submission to the Competition Commission, which would normally publish it. On payment systems, it was not clear where matters were heading and the Bank would be having discussions with the Treasury. The dialogue would be more in the nature of an on-going discussion rather than a single paper.

The Governor noted that the lender of last resort point made by the Cruickshank Report seemed to be very much an aside. It had immediate relevance to Court, whose position was that support would be revealed in due course but without a timetable. Any move to a timetable would be resisted. Mr Davies said he strongly supported that point. The Cruickshank recommendation was only loosely grounded in the analysis in the Report and it was not at all clear what it had to do with the issues Cruickshank had been invited to consider. The disclosure issue had been discussed with him exhaustively. The UK was at the leading edge of transparency in this area and he would be very reluctant to think about unstitching current policy. The market had been told what policy was, it had been set out in the MOU and he did not see a case for changing it. The Governor said he was tempted to say that it was not clear that Mr Cruickshank understood what current arrangements were.

FINANCIAL MARKET OPERATIONS ISSUES
Current Issues
(Messrs Plenderleith, Clark and Vickers in attendance)

Mr Plenderleith reported that the fifth gold auction had passed off well, and it had concluded the first financial year's programme. There would be nearly two more years of bi-monthly auctions, with the next in May. The price achieved had been very much in line with the average daily price of gold throughout the period of the sales, which suggested that the auction process was working well. But the National Audit Office had announced an inquiry into the sales. It would be looking at whether the Treasury and the Bank, as the Treasury's agent, had managed them in a sensible way. He did not believe the Bank had anything to fear. However the mindset of the NAO was that it wanted to find something to criticise. The Bank would have to make sure that the NAO's assessment was well founded.

Mr Plenderleith noted that, as agreed with Court, it had been announced that the three year note programme would be transferred from the Treasury to the Bank, starting next year.

Mr Plenderleith advised Court that at the beginning of April the management of Government cash flows day by day had been transferred to the Debt Management Office. The transition had been extremely smooth.

Future Strategies for the Registrar's Dept
(Messrs Clark, Plenderleith and Vickers in attendance together with Ms Lowther)

Mr Plenderleith reminded Court that the Bank continued to act as Registrar under a five year agreement with the Treasury, of which two years had elapsed. But given the diminishing scale of the business it had been felt necessary to look forward to see how it would develop after that timescale.

Ms Lowther said that the paper before Court was about what to do with gilts registration, and it would be sent to the Treasury. The paper reflected the restructuring project at the Registrar's Department, which wished to influence its own future. It also reflected the fact that the Bank's situation had changed since the last discussion of the subject with HMT. The Bank was no longer the debt issuer or the gilts settlement provider. If the Bank did not engage with the Treasury now, opportunities to reduce risks in the gilts market and to provide savings for the public sector would be missed, and the financial position of Registrar's would also deteriorate. It all came down to being able to plan with confidence. The paper outlined three possibilities, which were not mutually exclusive. They were set out in paragraph 1.5 of the paper and related to business expansion, business re-engineering, and business partnership. She noted that business re-engineering alone might not provide a stable long-term position. The Bank was talking now to the Treasury so that some of the more imaginative ideas could be explored at a time when there was no immediate pressure for action. If the Treasury did not wish to take up the more imaginative options it would not be too late to pursue the option of merger with another company.

The Governor said that Registrar's had responded magnificently to the pressures under which it had been put and was behaving sensibly and realistically by looking at the way ahead.
Mr Buxton asked why the number of holdings was down 10% a year and wondered whether the more imaginative options were only interim steps in the decline, so that the Bank should look at selling the business while it had value. Ms Lowther said that the retail interest in gilts was less than in the past, and most of the holdings that Registrar's looked after were related to the retail end of the market. Redemptions were not being re-invested in gilts on an equivalent scale, so holdings declined. Mr Plenderleith said that the exit route would be available if the Treasury

could not be satisfied on costs. If that were the case, the Bank could negotiate an earlier way out of the business. Whether that third option was chosen depended on whether a private sector registrar thought it was a business worth paying for and whether it believed it could do the work more cheaply. It was doubtful whether it would be done to the same quality. The Bank wished to explore the first two options before turning to the third. Sir Neville Simms said they were three eminently sensible options but until a proposal was prepared it was very difficult to say whether they were more than good suggestions. The Governor suggested to Court that the Bank engage with the Treasury on the issue. Court was content.

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

The Governor reported the death of John Fforde on 10 April. By way of background, he added that Mr Fforde had been the Bank's Chief Cashier between 1966-70, Executive Director of the Bank with responsibility for Home Finance between 1970-82, Adviser to the Governor between 1982-84 and had been the Bank's Official Historian from 1984-92. The Governor said that Mr Fforde had been one his own great mentors and he was very sad to hear the news.

The Governor advised members that Governors' Day at the Bank's Sports Club would take place on Sunday 23 July. He pointed out that formal invitations to the event were in Members' folders and he encouraged as many as were able to attend.

Mr Clementi drew Court's attention to "Freedom within a Framework", a guide recently issued to staff which provided an overview of the learning and development opportunities available.

Turning to *BenefitSelect*, Mr Clementi noted that the new programme started on 1 April and was working smoothly. A small number, under 100 staff, took all their benefit points in cash. For the rest, all possible combinations had been chosen, suggesting that the old fixed menu was sub-optimal. Twelve staff had not signed, and the Bank was having detailed discussions with them. The Bank genuinely believed that each of the twelve was no worse off but it needed to show that to them, and was encouraging them to go to independent financial advisers. One or two, though better off, were taking a stand on principle, and might go to a tribunal.

Mr King described the new schools' competition, "Target 2 Point 5" which was sponsored by The Times alongside the Bank, to help with publicity. A series of articles had begun in The Times on 10 April. The broad outline of the competition was the same as when Court had discussed it before. A team from each school would take on the role of the MPC, presenting the case but not directed at finding an answer that was right or wrong. Judgement would be based on the quality of the presentation and the way the arguments were marshalled. To help the competition, the website was being expanded and competitors would have access to a sub-set of MPC data. Resource packs were being distributed, initially for those responding to the brochure and then for those taking part in the competition. The start would be in the Autumn, it would be completed in the Spring and the Governor had promised to give the prize to the winner. Just over 700 schools had filled in the forms on the brochure. The number of entries would be known in September and with the possible exception of Scotland, the distribution of those expressing interest was uniform around the country. Mr Neill said the plan was excellent. He noted that he had run a game for managers which had also been tried with 16 year olds in secondary schools. On every occasion they beat his company's managers.

The Governor noted that the Court of Appeal had decided in the case of Bradford Investments to throw out the case against the Bank. The judges had agreed three nil and had made disparaging remarks about the litigant being close to vexatious. The Bank had received the judgement that morning.

MANAGEMENT OF THE BANK

Finance

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

In the absence of Mr Midgley, Mr Clementi drew Members' attention to schedule A(2). This showed that total income for the year was £336 mn against £320 mn in the budget. In part, this was because investment income was above budget but the main reason was that banking fees and commissions were well up on budget, particularly as a result of good margins for currency deposits. Expenditure of £207 mn, compared with a budget of £213 mn, was lower because some savings had been achieved more quickly, for example in PSSD, where staff numbers were 265 against 301 in the budget, and expenditure was also below budget because of deferrals.

These included some spending in the Head Office Refurbishment Programme, and lower than expected spending on new Banking Department systems, though that was not necessarily a good thing. Mr Clementi also noted the adjustments to profits and movements in provisions which were for discussion at the Audit Committee that afternoon. He noted an operating profit before tax of £124.9 mn, which was ahead of the £105 mn budget and represented a return of more than 9% on shareholders' funds of £1.3 bn. There were no questions.

The Annual Report – in draft
(Messrs Clark, Plenderleith, Vickers and Footman in attendance)

Mr Clementi drew attention to section 6 of the draft, setting out the ten objectives for the year to February 2001. All but number 9 had been looked at in the strategic review in December, but had not been formally approved. Number 9 had been looked at in the budget in February and had been formally approved.

Mr Footman drew attention to a number of changes in the draft, including some proposed at the previous Court meeting. In response to a suggestion from Sir David Cooksey, the Governor said the Bank would take up the fact that the Non Executive Directors' time spent with the Agents had not been mentioned in the Report. Members of Court made a number of other detailed comments on the Report and the Governor said that any other drafting comments or matters of detail should be provided to Mr Footman outside Court. Sir Ian Gibson said that the section on Financial Stability had benefited very much by being grouped together in one place in the Report.

The Governor invited Court to approve the Bank's objectives, other than objective 9, which was approved during the budget discussion in February. Objectives 1-8 and 10 were approved.

Houblon-Norman Fund Report and Accounts
(Messrs Vickers, Clark and Plenderleith in attendance)

There being no questions on the accounts, Mr Vickers described the work of three recent fellows, Dr Niall Ferguson, of Jesus College, Oxford; Xavier Freixas, Professor of Economics at Universitat Pompeu, Fabra, Barcelona; and Professor Ronald McKinnon, Professor of Economics at Stanford University. In recent months there had been a hiatus, partly because

Peter Sinclair had been elected to a fellowship and then took over the directorship of CCBS. He noted that Larry Ball of John Hopkins University would soon be joining the Bank for about a year to study inflation inertia and the cost of recessions. Three who would be joining later for a total period of work of about twelve months - between them - were Dr David Cobham, reader in economics at the University of St.Andrews, Professor Charles Chimi Okeahalam, the Donald Gordon Professor of banking and finance at the graduate school of business administration, University of Witwatersrand, South Africa, and Professor Rafael Repullo, Professor of Economics and Director, CEMFI, Madrid. [redacted]

Indemnities for Members of Court

Mr Clementi said that some members would recall that in 1998, Court had approved a policy indemnifying members against personal civil liability arising out of the performance of their Bank duties. This had been in line with practice adopted by the Government to protect Board members of non-departmental public bodies.

The Government had recently revised its policy on indemnities and had widened the scope and it was now proposed to revise the position for Court members. Because the Bank of England Act 1998 required interested parties to withdraw from Court, it was proposed that Court, in the absence of the Governors, could pass a resolution covering the Governors, and the Sub-Committee of Court established to determine the remuneration of Non-Executive Directors, could pass the resolution covering the Non-Executive Directors. Mr Clementi said that the Minutes of the meeting of the Sub-Committee would be brought before Court the following month.

Court endorsed the extension of the terms of reference of the Governors' committee from determining levels of remuneration of the Bank's Non Executive Directors, with the approval of the Chancellor, to include considering and passing a resolution indemnifying the Bank's Non Executive Directors against personal civil liability arising out of the performance of their Bank functions.

The Governor said that the indemnities would be disclosed in the Annual Report.

The Governors withdrew from Court and in accordance with Schedule 1, Paragraph 13 (3) of the Act, Dame Sheila Masters took over the Chairmanship of Court and invited Court to pass the following resolution:-

To resolve that the Governors be indemnified by the Bank against all costs, charges, losses, expenses and liabilities incurred by him or her in carrying out or purporting to carry out any of his or her functions, provided that he or she has acted honestly and in good faith and has not acted recklessly.

The resolution was PASSED.

In response to questions from Mr Neill, Mr Baillie and Sir David Cooksey, Dame Sheila Masters said that the Bank was not proposing to pay any premiums for insurance cover in the market. But she would pass on to Mr Clementi their comments about whether a benefit in kind might be involved. The Bank would look at this issue.

Court was up.

Sheila V Masters
5 May 2000

Peter Rodgers
5 May 2000

A COURT OF DIRECTORS AT THE BANK

FRIDAY 5 MAY 2000

Present:

The Rt.Hon Eddie George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Dame Sheila Masters, Chairman, Sub-Committee of Directors
Mr Bailie
Sir David Cooksey
Sir Ian Gibson
Sir Chips Keswick
Ms McKechnie
Mr Morris
Mr Neill
Ms Kathleen O'Donovan
Sir Neville Simms

Absent:

Mr Allsopp
Mr Buxton
Mr Davies
Mr Hawker
Mrs Heaton
Mr Stretton

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

The Bank's Report and Accounts in draft together with a Report from the Audit Committee
(Messrs Clark, Plenderleith, Vickers, Midgley, Footman and Darbyshire, together with Messrs Smith and Higgin, from PricewaterhouseCoopers in attendance)

The Governor invited Mr Clementi to introduce the discussion of the Report and Accounts and the Report from the Audit Committee. Mr Clementi said the Accounts were broadly in the same form as last year. He noted that an explanation had been drafted for the Directors' Report of the fall in profits from £172 mn to £123 mn, describing it as a result largely of lower levels of CRD's and to a certain extent of interest rates. Mr Clementi said that more important for him was the comparison with budgets. The broad picture was that income was slightly ahead and expenditure was slightly behind. £123 mn was slightly more that the budgeted profit. The income and expenditure figures differed very slightly from the figures presented in the Quarterly Financial Report to Court the previous month. There had been an adjustment of £1.5 mn that previously was charged to the Issue Department and it had now been decided that it should be borne by the Bank. With that exception the statutory Accounts came directly from the management accounts that Court had already looked at. He noted that the Audit Committee had been taken through a number of changes in the provisions related to redundancy, retrenchment and post retirement benefits outside the pension scheme. He also noted a release to the profit and loss account for NMB of £5 mn, representing the difference between the previous provision of £72 mn and the £67 mn struck after the sale. This was fully disclosed in the Accounts on page 80-81. Mr Clementi said the Bank regarded it as a clear example of the principle it adhered to in support operations of full disclosure once the systemic risk was behind. Mr Cruickshank in his Report had raised the issue of disclosure within 12 months, and Mr Clementi said he had drawn attention to the point in the Accounts, to make sure that Court was happy with the accounting procedures and treatment the Bank used in this connection. On page 67, note 1A described a key aspect in which the Bank's Accounts differed from private sector conventions in this respect.

Turning to the Accounts themselves, Mr Clementi drew attention to the substantial rise in the footings on page 65, which was essentially because Target balances had risen. It was hoped that next year there would be a proper netting arrangement. He also drew attention to the cash flow statement on page 66 which the Bank was obliged to make, but whose usefulness was questionable. He drew Court's attention to a number of specific points where opinions were attributed to Members of Court. These were in the last paragraph of note 1(A), towards the end of note 1(E), Court Members' valuation of investment securities and a participating interest in note 11, the paragraph about the financial statement of subsidiaries in note 12, the references to Directors in note 23(C) and the reference to BCCI in note 25 on contingent liabilities. With regard to the latter, it was just possible that a judgement would appear before the publication of the Report and Accounts and so the Bank would have to react to that.

Sir Neville Simms reported that the Audit Committee had reviewed the Accounts with the Bank's executive and PricewaterhouseCoopers on 19 April. He noted that Mr Clementi had covered a number of the matters concerned. An issue the Audit Committee had looked at in particular was to ensure that there was still room for a degree of masking of support operations. Having taken the advice of internal departments of the Bank, the Committee believed there still was. The Committee was also content with the note on BCCI and contingent liabilities, and also with the way NMB was dealt with in the Accounts. He noted that the Audit Committee and the Auditors were content with the release of half of the retrenchment provisions that relate to the refurbishment of Head Office. The Audit Committee was also pleased with the way ALCO had been set up and was running.

At the Governor's invitation, Mr Higgins said that the Auditors had obtained all the information and explanations required for the audit and had received the full co-operation of management. The Auditors had gone through the provisions in detail. He confirmed Sir Neville Simms' remarks on this issue. The Auditors had also reviewed the disclosures on Governance of the Bank, and were content with the approach. Looking forward, a question had been raised with Mr Clementi about whether future Annual Reports should make a statement about compliance with codes of practice such as the Listing Rules or Turnbull. Turning to risk management, the Auditor's view was that there had been considerable progress over the last few years and the overall framework had been improved. There were a number of areas for further improvement in the management of risk and the Auditors had put forward a number of proposals to consider.

The Governor noted that the Report and Accounts would lie before Court until 17 May. Court would then be asked formally to approve the Accounts and give permission for them to be printed, for the Letter of Representation to be signed and for the final payment, in lieu of dividend, to be made to HMT the following October. It was intended to publish the report and accounts on 24 May.

Court Pension Scheme – annual adjustment

Turning to the Report from the Trustees of the Court Pension Scheme, the Governor, having declared his potential interest in the Scheme together with those of the two Deputy Governors, invited Sir Chips Keswick, in his capacity as Chairman of the Trustees of the Court Pension Scheme, to introduce the Report which contained the following recommendations:

(a) the annual pensions in payment to former Governors and Executive Directors and allowances to the widows of former Members of Court be increased, with effect from 1 July 2000, by the amount of the increase in the Retail Prices Index for the twelve months ended 31 May 2000;

(b) similar increases be granted from 1 July 2000 to:

- i) the ex-gratia allowances payable to Lord Richardson, Sir George Blunden and Lord Kingsdown;
- ii) the ex-gratia payments awarded to widows of former Members of Court who retired prior to 1978 and whose allowances were based on their husbands' pensions net of commutation;
- iii) the deferred pensions payable at age 60 or later granted to Mr Flemming and Mr Pennant-Rea;

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

Court APPROVED the recommendations.

Appointments to Court

The Governor said that the Chancellor had agreed to reappoint to Court Ms McKechnie, Mr Morris, Mr Bailie and Mr Neill. He was delighted that this had happened. He said that sadly Mr Hawker, because of the situation at Hyder, had written to him saying that he felt it appropriate to step down at the end of his term. He also noted that Mr Allsopp's appointment to the Monetary Policy Committee, which had been announced the previous evening, would require him to step down from Court at the end of the month. He hoped that an announcement would be made the following week, possibly on Thursday, on the succession to Mr Hawker and Mr Allsopp on Court. He would be looking for an opportunity to say farewell to Mr Hawker and to Mr Allsopp in his current capacity and would be in touch to find a date.

Court was up.

Sheila V Masters
17 May 2000

17 May 2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 17 MAY 2000

Present:

The Rt.Hon Eddie George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Dame Sheila Masters, Chairman, Sub-Committee of Directors
Mr Allsopp
Mr Bailie
Mr Buxton
Sir David Cooksey
Sir Ian Gibson
Mrs Heaton
Ms McKechnie
Mr Morris
Mr Neill
Ms Kathleen O'Donovan
Mr Stretton

Absent:

Mr King, Deputy Governor - Monetary Policy
Mr Davies
Mr Hawker
Sir Chips Keswick
Sir Neville Simms

The Governor reminded members that Mr Allsopp would be leaving Court on his appointment to the MPC and Mr Hawker had chosen not to seek reappointment, given events at Hyder. The Treasury was intending to announce their replacements that morning. They were Sir Brian Moffat, the Chairman of British Steel, now known as CORUS Group Plc, and Ms Bridget Blow, Chief Executive of ITNET. The Governor expressed his appreciation on behalf of Court to Mr Allsopp for his contributions to Court, anticipating his contributions to the Monetary Policy Committee, and also his appreciation to Mr Hawker, in particular for his contribution to the Agency in Wales, where he had been a tower of strength. The Governor said the Bank was seeking to arrange a dinner to say farewell formally.

The Minutes of the Court of 5 May, having been circulated were approved.

MONETARY STABILITY ISSUES

Inflation Report together with the economic and monetary discussion, incorporating the monthly MPC Report to Court, followed by an update on international economic developments (Messrs Clark, Vickers and Plenderleith together with Professors Buiter and Goodhart and Dr Julius in attendance. Messrs Jenkinson and Stephens also attended).

In presenting the monthly MPC Report to Court, Mr Vickers said that the Bank's official interest rate remained at 6% in May after a unanimous vote by the MPC. The May Inflation Report had stressed that the outlook on the central case was for steady overall growth with low and stable inflation. Imbalances had, if anything, widened further in recent months, with signs of greater domestic cost pressures, but the exchange rate had been strong, and over the three months since the last Inflation Report had strengthened further, though it had come off a little in recent days. Mr Vickers drew attention to the fan charts in the Inflation Report and table 6(b). He noted that there were risks and perhaps turbulence ahead. The MPC would continue to set interest rates with the aim of hitting the inflation target.

Internationally, the FOMC had raised rates by 50 basis points to 6.5% on 16 May. Turning to the domestic economy, it would be important to watch closely to see if there were a significant underlying slow down. Initial estimates suggested that GDP grew by 0.4% in the first quarter and was 2.9% higher than a year ago whilst services grew at 0.8% and were 3.2% higher than a year ago. This was weaker than the Bank projection. Manufacturing fell 0.5% quarter on quarter. Energy output was weak. The output based estimate of GDP appeared relatively low against stronger expenditure seen in retail sales and trade figures. There was a possibility that the first quarter might be revised up.

Turning to the near term prospects, Mr Vickers said that surveys suggested that while manufacturing growth in the second quarter would be positive it had fallen back quite significantly. Consumption had grown strongly and house price inflation was in the mid teens still, while in March lending to households was up 9.9% on a year before. However, consumer confidence fell further in April. Some leading indicators for the housing market suggested a deceleration. M4 and M4L were exceptionally strong in March with loan approvals above last year's peak. Surveys pointed to slower growth and business investment in the second quarter while exports were likely to have grown strongly in the first quarter. Looking ahead, export growth was likely to slow but remain positive.

In the labour market, headline annual earnings growth was 5.8% in March, down 0.2 percentage points. Excluding bonuses, earnings grew by 4.7% in March, down from 5.1% in February, but the relative positions of the private, public, manufacturing and services sectors remained as before. The claimant count unemployment rate fell to 3.9% in April, and ILO unemployment was down 20,000 and employment was up 55,000. Producer prices edged down in April while annual commodity and input price inflation may have peaked in February. Mr Vickers noted that RPIX rose by 1.9% in April against a year ago, down 0.1 percentage points because of falling utility prices. RPI rose to 3% on a year ago as MIRAS was abolished while HICP and RPIY rose 0. 6% and 1.6% respectively. The gap between services and goods inflation fell, again partly because of utility prices.

Commenting on the markets, Mr Plenderleith said that a notable development had been a quite material easing of sterling, visible in chart 1. In the past two weeks the exchange rate index had fallen substantially from a peak of just under 114 to between 108 and 109. This however brought it back only to the level early in the year, which itself still represented a material appreciation over the previous year. A possibly more significant feature was the move downwards in sterling against the dollar. The pound may in some sense have decoupled from the dollar and had moved back 10 cents or more. Sterling had also given up some recent gains against the euro, but not much, because the euro was extremely weak. It was possible that sterling's' fall in the two weeks since the MPC meeting was an erratic movement resulting from flows through the markets that might not persist. There had certainly been some M & A related flows. A more fundamental hypothesis was that there was a shift in market perceptions of the real economic prospects of the US, the euro area and the UK, with a growing awareness that the US was expanding extremely strongly which could lead to more vigorous action by the Fed. The previous day the FOMC had raised rates by half a percentage point and given a clear steer that there was likely to be more tightening. Furthermore, in the euro area there was some evidence of inflation pressures as core economies recovered, so there was an upward prospect for interest rates. In the UK, the markets thought that a rise was likely at some stage but the size of the rise looked for did not seem as much as in other economies. So sterling had fallen against the dollar, moving more into line with the performance of the euro. Whether that would last depended on whether the shift in market perceptions was justified. But it did ease the pressures caused by the pound.

Mr Buxton said he did not believe the position had changed much since the previous month. The economy was pretty strong except in certain sectors. Confidence had toned down. Services were doing well and research showed that, while companies had increasing confidence in their own businesses, when asked about the economy, confidence was going the other way, and decreasing. The data seen though banking accounts indicated that businesses were doing very well. Manufacturing was showing a mixed picture, agriculture was not doing well, but consumers were still spending. Sir Ian Gibson said that as a result of price movements in the UK, prices were now within 5% of Spain and down 12% in the last couple of quarters. Spain, with its mix of market conditions and rates, was the next best market after the UK for non-Spanish manufacturers. Demand in the euro zone, apart from Germany, had looked as if it was taking a down turn, but it had turned up again. Initially it was remarkable high and growing. It was assumed that eventually the growth in the rest of the euro zone would push the German market up, but not until the final quarter of the year. German manufacturers had the most capacity in Europe and their vehicles were going into these other markets. In the UK, industry's big fear, following the announcement by Ford and the changes at Rover, resulted from the fact that none of the top five sellers produced volume cars in the UK. The decisions made were commitments for the next ten to fifteen years. The industry feared a quite dramatic series of changes over the next two years. Margins were coming down in the UK, though they were still higher than on the Continent. The component sector was in the process of significant shrinkage. Continental markets were holding up well. The component sector was not benefiting because it did not have the contracts for Continent assembled vehicles.

Mr Morris said the debate about economic performance was focusing on one factor, sterling. He noted that the MPC had set out as a deliberate strategy to seek to build a constituency of support for low inflation. He wondered whether the key element of delivering low inflation was sufficiently promoted in this effort to achieve wider understanding. The numbers were good and the argument about stability was well made and everybody was enjoying the benefits of that. However, particular sectors were volatile. He did not see a balanced debate in terms of public opinion. At some point it might be worth looking to see how the debate could be broadened to achieve a greater realisation that the factors that deliver low inflation were important, and to get that into the public domain.

The Governor commented that it was always the case that suffering sectors made the most noise. If the debate were judged by the media it was bound to lead to a perception of imbalance in the debate. His experience of direct discussion face to face was that there was a much broader understanding of the issues. Even some of the editorial comment in the media was more balanced than might be expected. Mr Morris said that listening to the CBI and some trade associations it was not possible to hear the balance. Informed opinion would take a more balanced view but sometimes irrationality would take over. He asked whether the Bank had a wider role in seeking to promote the case for low inflation. Mr Bailie said he did believe people understood. He had been involved in a lot of debates about such issues with people in manufacturing. The CBI Northern Ireland fully understood that it was not within the gift of the Bank to interfere in the foreign exchange markets and it did not believe the Government should do so. They knew that it would increase inflation and interest rates.

In Northern Ireland there had been no evidence of massive unemployment or cutbacks by companies, which were holding on to the business they had, even if they were not generating new business. However, there was a very strong belief that the euro would eventually strengthen. If they really believed the current level of sterling would operate indefinitely then there might be some different decisions. Mr Bailie also noted the importance of political issues in the Northern Ireland context, now there were 108 assembly members and 36 district councils. Turning to TV advertising, on a UK basis, he noted that it continued at a high level, largely driven by dot com companies using conventional TV, point of sale and printing promotions. In reply to a question from Mr Allsopp, Mr Bailie said that he believed that wage inflation in the Republic of Ireland was at a much higher level than expected. Mr Buxton noted that Ireland was now a country of immigration not emigration.

The Governor invited Dr Julius, Professor Buiter and Professor Goodhart to comment on the monthly report or indeed on the three years of the MPC. Professor Goodhart said it had been an interesting and fascinating time and relatively successful and he hoped it would continue to be relatively successful. Professor Buiter said he thought that he and Professor Goodhart were leaving just at the right time. The Governor said that he very much appreciated the contributions both had made to the relative success over the last three years, not just to the outcomes in terms of decisions but to the process and to the meetings. Professor Goodhart apologised because of a commitment at the LSE and withdrew from the meeting.

In presenting his paper on international economic developments, which addressed the main current issues of the world economy, featured in the May edition of the Quarterly Bulletin, Mr Stephens said that the news since February had confirmed the stronger outlook in the US. There had also been a strong rebound in many of the emerging market economies in 1999, most pronounced in Asia, but also evident in Latin America and elsewhere. In the euro area it was very much a year of two halves, with a relatively weak first half and then more marked strengthening in the second half which had continued into 2000. In Japan, while there were distinct signs of the early stages of a recovery, the data for the fourth quarter of 1999 indicated a fall in output, though a rebound was expected by the Bank in the first quarter of this year. That said more about the highly volatile nature of Japanese data than about the strength of the recovery. Turning to the outlook, most forecasts were looking to 4.5% GDP growth for the world this year, declining a little by 2002. It would be pretty broadly based, with the United States accounting for about 25% of growth (as against 50% in 1998). Like most forecasters, the Bank judged that the main risk to world activity could come from a sharp correction of equity markets, perhaps starting in the US, but affecting other countries too. The MPC saw this as a downside risk to its central projection for the world economy.

Mr Stephens noted the significant pick up in core inflation in the US since January and the more modest increase in the euro area although in both economies inflation had dipped in April. The crucial aspect for the United Kingdom was how these movements translated into export prices. He noted, with regard to the United States, that one question was whether the pick up in productivity growth since 1995 had been as significant as previously thought. If it were not, inflation could pick up faster and so could interest rates, while equities could fall very sharply, leading to a significant fall in consumption and GDP growth.

Agents' issue of the month - Investment
(Executive Directors, external MPC members, as shown above, together with Messrs Jenkinson and Bailey in attendance).

Mr Bailey, the Bank's Agent for the South East and East Anglia, noted that the Inflation Report in February had shown that, whereas investment had been sluggish in the previous year, survey data suggested that investment intentions were picking up. The purpose of the Agents' question on investment was to dig beneath that and see what was actually happening. The Agents questioned 154 companies. Mr Bailey drew Court's attention to the summaries which showed that over the last six months companies were more likely to have raised their investment plans than to have cut them. The more positive sectors were construction and non retail services. Manufacturers appeared neutral. However, the largest group had left their plans unchanged - many were slow to change their annual investment programmes. Over the following two years 48% of companies planned to increase IT spending while only 30% planned to reduce it. Only 18% reported sharp cuts in IT spending, after millennium investments. Construction and non retail services were the most positive on IT investment, while e-commerce and internet were the most frequent motivators for IT investments. Mr Bailey noted that 45% of companies claimed to have made no significant borrowing in the last six months. Of those that had borrowed for domestic UK purposes, financing new investment was by far the largest motive. Borrowing to finance stocks or unexpectedly low profitability was less significant at present. Mr Bailey said that replies analysed by turnover gave no additional information. Overall, investment intentions were more positive than the national accounts figures for 1999 had suggested, and he was pleased that the new national accounts figures were confirming this by showing signs of an upturn in investment.

The Governor said that the survey was a very good example of this kind of exercise. It was not a science, but it did address a puzzle, and give the MPC a better feel, which influenced attitudes to what may be happening at the margin. Dame Sheila commented that it shed no light on whether the quantum was rising or falling, because the question only referred to a comparison with planned investment. The Governor said that if the responses had been more negative it would have affected the MPC's understanding of how it interpreted survey evidence. The answer given was consistent with the evolving data. Sir David Cooksey said there was a real divide in manufacturing between high value added companies, where there was an incentive to invest, and low value added companies, which were giving up the struggle and investing abroad. He asked whether there was any information in the survey that could throw light on that. Mr Bailey said that from the comments made by firms it was evident that some manufacturers with good products and markets were stepping up investment, but a more general view among manufacturers was related to their wish to get interest rates and sterling down, reflecting pain among certain companies. This was part of the dichotomy in the manufacturing sector. Mr Bailie asked whether there would be value in tracking the outurn in six months' time against what companies had said. The Governor said that was a possibility. Hopefully it would be seen in the data. It was a subject that the MPC would be likely to return to.

Mr Buxton said that small business was a net depositor so it was not surprising that 45% of companies had made no significant borrowing in the previous six months. The same applied to a significant number of mid-sector companies as well. The Governor commented that the absence of distress borrowing was another interesting point that came out of the survey. In response to a question from Ms O'Donovan, Mr Bailey said that a few of the companies questioned were subsidiaries of international companies. Most of those which replied were indigenous United Kingdom SMEs. In reply to a question from Mr Buxton about how many survey forms were sent out, Mr Bailey said about 165, and most were dealt with face to face or on the phone. It was not a question of sending out by fax and hoping that they would come back. The Governor commented that that would produce much less information. Mr Buxton said he was very encouraged to hear how the survey was done, though he would like to see a bigger sample. Mr Jenkinson said this was a typical size sample of ten to fifteen per Agent. A larger sample had been used in the past on occasions - for example the recent pay survey had been spread over two months and the sample had grown to more than two hundred. Mr Bailey said that there was not a great deal of time to ask questions because the MPC wanted immediate answers. Sir Ian Gibson asked whether the MPC could pose questions about whether companies were changing from UK investment to overseas sourcing. The Governor said that was a good idea and the Bank would take note of that. In response to a question from Mrs Heaton about the split by sector on IT investment, Mr Bailey cautioned that the sample was too small to draw too many conclusions. Mr Jenkinson noted that the next monthly Agents' survey would be on e-commerce.

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FINANCIAL STABILITY ISSUES

Domestic and international developments
(Messrs Clark, Vickers and Plenderleith in attendance)

Mr Clark noted the proposed merger between the London Stock Exchange and Deutsche Börse under the name iX. He said a lot of the detail had been trailed in the press. The move reflected general pressures towards consolidation in the markets. A second factor was that a number of major broker dealers and other market participants were not keen to be put in a position where they had to make an open choice between London and Frankfurt; to the extent that those markets were combined that choice was avoided. A number of issues remained unresolved. These included how the trading mechanisms would be supported by other parts of the infrastructure, and the question of what happened to derivatives. The latter was a particular concern to the LIFFE market. There was also the issue of how the split between the markets would operate in practice. There were potentially four or five market sectors involved. There was also an issue of how to regulate the primary market, in the sense of listing and disclosure. How this would be sorted out was not clear yet. There had been discussions about these issues. There were particular questions, for example, about the currency denomination of trades, including listings in euro. All these questions were principally for the providers of market services to address. There would be a more detailed prospectus for the merger in two to three months time and this would provide the basis for a decision by members on whether to approve it. From the Bank's point of view, some of the main considerations related to assessment of risk, particularly in clearing and settlement. In particular, it would look at the degree of concentration if a facility to service a very large part of the European capital market emerged. The Bank would also be looking to see that firms in London could access the infrastructure on terms no less favourable than elsewhere, so there was no disincentive to doing business in the City.

On a separate point, Mr Clark said that towards the end of 1999 the Settlement Finality Directive was implemented by the UK. Its intention was to make clearer the law on systems that transferred value. To benefit, a system had to be designated, and responsibility for designation in the UK belonged with the Bank of England. He noted, for the record, that the Bank had designated the CHAPS sterling and euro systems, exercising its powers under the Directive.

Mr Buxton asked Mr Clark what he thought was the future of the Stock Exchange. The proposal looked like a fudge. Mr Clark said that it depended what was meant by a fudge. Certainly there were compromises and unresolved issues. But it was not a fudge in the sense that it responded to genuine pressure towards consolidation of trading machinery. He noted that the pressure towards a single or a couple of systems was more intense in clearing and settlement than in trading, where the barriers to entry were relatively low. He expected consolidation at all levels. But the pressure might be greatest in clearing. For settlement, decisions had to take account of national company law, so while there might be some consolidation at an international level there might still be settlement at a national level for some time to come. Mr Plenderleith said that he agreed, as a director of the Exchange, that there was some fudge. In an electronic market, the issue was not where it was situated but the terms on which players could access it, and where the head office and mind of the company were located. It was to be a UK company with UK governance and headquarters in London.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues

(Messrs Plenderleith, Clark and Vickers in attendance)

Mr Plenderleith said that £12 bn of the receipts from the mobile auction licence had been paid and the rest would be paid in the autumn, when Vodafone and Orange had met the conditions of their licences. The receipt of a lump that large was tricky to manage in the market but the role belonged to the Debt Management Office as it now had cash management responsibility. The Bank had offered technical help and the event passed off relatively smoothly.

Mr Plenderleith said that the Bank had an agency function for the Treasury in the management of the foreign exchange reserves. For the past financial year the Treasury had set an explicit profit target of adding seven basis points to a benchmark return over the year. This was quite steep given the low risk parameters for management of the reserves. The target had been met in the first half and beaten quite substantially in the second half as a result of taking advantage of a spiking in market rates because of the millennium date change. Now the Bank was trying to ensure that the Treasury did not raise the target, because the millennium change was not an every year occurrence.

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Mr Plenderleith said that the Bank was proposing to capitalise on one of its most successful products, the £10 note. The £20 note had been upgraded a year ago. A new £10 note would be issued in October. It would have the same three additional security features. As a historical figure, Charles Darwin had been chosen for the note. Given the number of £10 notes in circulation, it would take a while to replace all of them.

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

Mr Clementi announced some staff changes at Head of Division level. Spencer Dale would be moving from Monetary Assessment and Strategy to join Conjunctural Assessment and Projections. He would replace Neal Hatch, who would be moving to head Gilt-Edged and Money Markets Division. Peter Andrews would complete the circle by moving to Monetary Analysis to replace Spencer Dale. The moves would take place in early September.

MANAGEMENT OF THE BANK

The Bank's Report and Accounts for approval, including the final Dividend (Executive Directors together with Messrs Midgley, Footman and Berkowitz in attendance)

Mr Footman noted that the changes to the Annual Report since Court had last seen it were no more than cross references to page numbers and syntax. Mr Clementi noted two pages in Court folders showing amendments since 5 May. One was a result of an error which had omitted part of a cross-currency interest rate swap, which came to light in final checking. The other related to the BCCI disclosure on page 84. The Bank was on notice of a House of Lords judgement the day after Court. It was important to sign the Accounts on the Court day so that they were true and fair as of that day. He drew Court's attention to note 25, third paragraph, where there were marginal changes in the wording. [redacted]

[redacted]

The Governor asked Court's approval for :-

(i) the Report and Accounts to be signed and printed with publication on 24 May;

(ii) the Letter of Representation to be signed;

(iii) the final payment to HMT of £25.694mn, payable on 5 October.

Court gave its APPROVAL.

Matters Reserved to Court
(Messrs Clark, Plenderleith, Vickers and Footman in attendance)

Mr Clementi reported that the document entitled 'Matters Reserved to Court', which provided a record of issues and topics which Court had agreed should be brought to its attention, was subject to annual review by Court. Two small changes were proposed. The first concerned an amendment to reflect the fact that changes to the Trust Deeds for the Court Pension Scheme and the Staff Pension Fund required the approval of Court. The second proposed adding a reference to the indemnity provided to Members of Court that the process of agreeing such indemnities was a matter reserved to Court.

Court APPROVED the proposals.

A Report from the Chairman of the Remuneration Committee
(Mr Footman in attendance)

In accordance with Schedule 1 paragraph 13(5) of the Bank of England Act 1998, Mr Allsopp withdrew from Court. Sir David Cooksey noted that there was a standard contract for the external members of the MPC. The only variable was the number of days worked. Mr Allsopp, on taking up his appointment, would work three days a week in the Bank. The issue was what he did in Oxford for the other two days. He was giving up his directorship of Oxford Economic Forecasting as a result of a conflict of interest, but he had some teaching commitments to continue. It would suit Mr Allsopp and the Bank if he used one of his two Oxford days to pursue research for the Bank. He would also be employing one of his research staff for this purpose. It was proposed that Mr Allsopp would work three days a week in the Bank for a salary of £78,798 plus a 15% supplement in lieu of pension. Sir David said he would like Court's approval for the proposal on that basis.

There was a second question of how he worked in Oxford, which had been agreed in the Remuneration Committee and was agreeable to Mr Allsopp. There would be a separate contract, probably with Oxford University, to provide services for one day a week at the same rate per day as for the MPC. The contract would include the payment of his research assistant. RemCo would like to propose to Court that the Bank entered into two contracts for this purpose.

The Governor asked whether there would be a pension supplement for the fourth day. Sir David said that the proposed arrangement would suit Mr Allsopp well. Oxford would charge overheads on the contract and that would include a contribution to the University superannuation scheme which would be agreeable to Mr Allsopp because it maintained his University superannuation scheme contributions intact. The University would want something for facilities as well, and would negotiate with the Bank. The proposal had only been flagged to the University. Sir David said he was asking for approval of the structure.

In answer to a question from the Governor, Sir David said it was acceptable to Mr Allsopp. The University was keen to include him in its research assessment exercises. Sir David said he expected a disclosure in the Bank accounts of his salary and benefits as an MPC member and probably a footnote saying the Bank was sponsoring research by him at Oxford. The Governor said that Professor Nickell was in a similar position, but working for the Bank four days a week. The LSE had concerns about what that did to their research effort and he was not sure whether there was parallel treatment. He accepted that this was the way forward, but the

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question was whether there was consistency between people in similar positions. Mr Footman said that Professor Nickell had settled on four days. The LSE lost some of its research accreditation. In answer to a question from Dame Sheila about whether Professor Nickell's arrangement could be restructured, Mr Footman said that was a possibility, but another possibility was to look at whether something could be done directly for the LSE through research support. That was an LSE issue not a Professor Nickell issue. The Governor suggested that the Allsopp decision should be disclosed to Professor Nickell, to see if there were implications for his contract. It was not right to have a discrepancy between terms. Dame Sheila said she was content with disclosing the Allsopp arrangements to Professor Nickell.

The second item related to the Governor's own annual increment for which the principle determining the level of increase had already been agreed by Court in 1998. In the circumstances Court agreed that there was no need for the Governor to withdraw. Court was content with the proposals from the Remuneration Committee to increase the Governor's salary by 2.5% from 1 July 2000.

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