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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 JUNE 2000

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Mr Morris
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

Ms O'Donovan
Sir Brian Moffat

MANAGEMENT OF THE BANK - 1

Review of IT Strategy
(Messrs Clark, Vickers, Plenderleith and Midgley together with [redacted] in attendance)

Following the presentation Ms McKechnie asked what the cost of the proposed changes would [redacted] said that no price had been put on it and much of the cost would be in time spent by managers in the Bank. In answer to questions by Mr Neill, [redacted] said that the best way the Bank could stay abreast of current developments in IT would be to have the right people in the right place and to set expectations that they will develop understanding of developments. He also noted the importance of helping some managers lift their eyes from day to day work in order to take a broader perspective of IT issues. This was where the proposed skills and knowledge initiative came in. [redacted] said there was a process of osmosis of skills and technology issues. A variety of initiatives could be undertaken, including exposing senior management to technology organisations or organisations that make good use of technology. Such initiatives were very much more important than formal training programmes. He noted that technology was bracketed with foreign languages in the Bank's training manual. It was a core skill, however, which needed to be reacquired every year. The roles of the senior person at ManCo level and of the senior technical resources staff were partly to be acutely aware of what was happening in the industry, not necessarily technical, but what people were doing with the technology. It was best to do this by introducing new people to the Bank because it was very difficult with people who had only worked in a single organisation.

Mr Buxton said he would like to see a chart of how IT was now handled in the Bank. He noted that OCP was critical of the current way it was handled. He asked whether the proposal for three coalitions was a fudge and there should instead be a reduction to a single unit. He also asked what powers the IT champion would have. [redacted] said there should be a process of drawing together centrally in a reactive way that took account of plans generated in each business area, and then asking questions, based on those plans, about what it was necessary to do on a Bankwide basis. Some of those questions would be about the minimum the Bank had to do to facilitate those business area plans. The formation of coalitions would put pressure on local managers and introduce a bias towards asking questions about whether solutions could be shared with other parts of the Bank. [redacted] said that the business drivers and imperatives of the different parts of the organisation meant the coalitions were very different. Mr Buxton said it was usual in a business to have different front offices. But he noted the importance of having a strong driver from the centre for certain things. [redacted] [redacted] said that the three coalitions proposed were to be additional to some central Bankwide consideration of plans. In answer to a question about the power of the IT champion, [redacted] said that inevitably the businesses would be taking a lead on how much to spend and where to get value, while the champion would primarily have an advocate role. In answer to a question from Mr Bailie about whether that advocacy role was sufficient given that other organisations appointed a Chief Information Officer, who would not be cheap to hire, [redacted] said that the role of CIOs had changed. It had been to manage resources, but that took away responsibilities from business managers, who did not then think more broadly about what they should do. That was not what was proposed. The difference between the management role and having a very strong advocate was that the latter would be looking for opportunities for sharing wherever possible in the best interests of the organisation. He would have both a strategic and direction-setting role as an advocate and also a strong management role as custodian for those shared assets. [redacted] agreed with Mr Bailie that such skills were expensive to hire, but it was an issue that was felt worth addressing.

Ms Blow said that she had been in IT for many years and she believed that most successful organisations started thinking about IT strategy as a plank of business strategy. This was a hard step to take. What then happened was that business streams came up with their priorities which would be pulled together at the top through a business case process very similar to the one outlined by [redacted]. Top management could keep control. Otherwise an organisation would spend more money than it had. [redacted] said he absolutely agreed. The character of the recommendation was to ask the Bank to think hard about current strategy and business planning processes and to think how IT could be put at the heart of those processes. That would improve the quality of thinking early on in the process about the business benefits that may lie behind proposals.

Sir Neville Simms said it was right that the Bank had to put IT at the heart of business strategy. He felt that the recommendations were rather heavy on reviews and there should be a much greater training element. He also asked whether it was best to stop those parts of the Bank that were raring to go or to speed up the laggards. Finally he asked whether anybody had been spotted in the Bank who could potentially be the champion, or would the appointment inevitably be external? [redacted] said that in terms of speed of development of various parts of the Bank, that could be dealt with by offering different degrees of help to areas, as they required. He said he would prefer not to give an answer on the identity of potential champions. In answer to a question from Mr Stretton, [redacted] said it was important to identify skills and capabilities in an organisation as part of the process of identifying common pieces of the organisation. [redacted] agreed with Mr Stretton that it was important to identify in the decision-making process who spent the money.

Mr King asked [redacted] and [redacted] whether they would agree on three points. First, the IT challenges for many years had been to set up, maintain and operate quite large batch processing systems where failure would be a disaster. Now there had been a move away from that to thinking about IT challenges across all three parts of the Bank, and IT in analytical areas was very different. The same people were being asked to think about very different problems. The management of the Bank had used IT to replicate what it already did. There used to be a lot of meetings, then the cost of documents on the system fell so there were very many more documents. Now the same process had been repeated with e-mails. The Bank hadn't spent very much time thinking about how IT would affect the way it worked.

Second, how was the quality of people in IT rated. Despite salaries lower than available outside the Bank, there were some outstanding people in IT in Central Services. Third, he noted how hard it had been to deliver more training, which was hard to get into the schedules of overstretched staff. The Bank had not got a proper induction programme. He asked what would make it possible to deliver more training.

[redacted] said there was no doubt that the current skills and approach to dealing with IT were very strongly influenced by the legacy Mr King described in his first point. It was true that in relation to the analytical areas there were very big opportunities to influence and change the way people worked day to day. Those opportunities were not sufficiently high up the agenda as far as the Bank was concerned. He agreed with that perception. On the quality of staff, he said it was very difficult to generalise. Some were very good, with a terrific track record in delivering programmes. This was largely a function of what they had been asked to do in the past, in the way of major set piece systems. The Bank had people of the right quality, and what tended to be missing was receptiveness and willingness not just in IT but elsewhere in line management to pickup and run with some of the expertise that might be there. Some questions were not being asked and some solutions were not being offered.

On Mr King's third point, the best way to deliver training, [redacted] said that it had struck him very strongly when working with Monetary Analysis that the Bank ought to be able to do this well, because the knowledge was there. But the knowledge was with individuals and not codified, therefore it was quite difficult to train people about the way the Bank worked. Helping others get better in their work was not a key task that was valued strongly in the Bank.

Work in Monetary Analysis was moving in the direction of creating that capability. It was not really about training courses because those typically were generic, and it was not about the way tools and equipment were used; rather it was something that had to be done within an organisation.

The Governor thanked [redacted] and [redacted] for their presentation and Court moved to the First Floor Committee Room.

Baroness Noakes congratulated the Governor and Sir Howard Davies on their knighthoods. The Governor also offered his own congratulations to Sir Howard.

The Governor invited Mr Clementi to explain the next stages of the IT deliberations. Mr Clementi said that [redacted] was giving a series of presentations in the Bank and it was hoped to collect views from as wide a group as possible before determining the future course of action. He noted that there had been a joint Govco/Manco meeting to discuss the issues, including preliminary views on how the Bank's planning process could be changed. IT proposals would be a major part of the senior staff conference in October, and at the November Court there would be a presentation as part of the Bank Strategy Report, and he expected to give Court a formal response to the recommendations. The recommendations proposed that the Bank needed to be very much more open and transparent about the way it planned IT. That should be brought to Court as part of the regular annual planning process. There were a number of other recommendations and he was pretty sympathetic to all of them, but he believed the consultation process should be completed before coming back to decide what to do. How to implement changes was harder than how to agree the principles. He was very sympathetic to the approach based on three businesses within the Bank. The management challenge would be to bring the coalitions closer without trying to fit them into a single jacket and without undermining line managers.

In answer to a question from Mrs Heaton, Mr Clementi said that it was the Bank's intention to keep OCP informed of future developments. He believed they had done a good job and had heightened the debate on IT in the Bank. There were some organisational issues. For example, asking existing people to do similar roles invited the same outcome as the Bank had now. There were some important organisational and personnel issues to grapple with. Mrs Heaton said that one of the messages she had received from the morning's discussion was the advantage of having an outsider to challenge the Bank. She hoped there would in some way be an ongoing external force. If this was not OCP, then an advisory group could take that role. Quite useful thoughts had come out of the Audit Committee and there might be an advantage in having a similar IT group. Mr Clementi said he had spent some time with Mr Neill and Mr Buxton discussing the issues and he was very grateful to them and his intention was to keep them involved at least until November. The Governor noted that when it came to implementation of proposals the Bank would want to keep them engaged.

Mr Neill noted the importance of addressing the issue of the implications for IT, going forward, of the way people worked in the Bank, and in particular knowledge management, because that was what he believed the consultants were referring to under their fifth proposal. Baroness Noakes noted that November was a long time ahead, and she asked whether anything would change before then. Mr Clementi said that he could give a brief progress report to subsequent Courts, but November would be the date for the formal response. He nevertheless did anticipate some changes in the Bank, perhaps in the next two to three weeks. The first would be clear instructions to managers, as the Bank went about the planning process, to take account of IT plans and set out ways of measuring performance against objectives. Mr Vickers noted that the OCP review in Monetary Analysis had been going full steam ahead and a lot was going on. Mr Buxton noted that Mr Clementi had said the Bank would be careful not to take responsibility away from business heads. He agreed on IT development issues, but what the Bank needed was a strategic structure in the centre within which those business heads had to work. It would include common architecture and common back office. Business heads would have to develop within that. Some authority had to be taken from business heads. Out of the review he hoped the Bank would produce a centralised policy within which the business heads would have to work. The Governor said the Bank would take note of Mr Buxton's point.

Turning to the rest of the agenda, the Minutes of the Court of 17 May, having been circulated, were approved. The Governor also extended a warm welcome to Ms Blow on her first attendance at Court.

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MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC Report to Court (Messrs Clark, Vickers and Plenderleith together with Dr Julius and Professor Nickell in attendance).

Mr Vickers said that the Minutes of the June MPC meeting, released that morning, showed that the vote was six to three for maintaining rates at 6%. He noted two main questions, which were whether domestic demand growth had slowed and the consequences for the inflation outlook of the fall in the pound. Turning to the international economy, he said there were signs that the US was coming slightly off the boil. He noted that the Fed would meet later in the month. The ECB had raised rates by 50 basis points to 4.25% on 8 June. Japan appeared to be recovering, but it was important to be very cautious. He noted that OPEC was meeting that day. UK GDP growth was revised up a little to 0.5% quarter on quarter and to 3.1% on a year ago, but a number of puzzles remained in the pattern of demand in the economy and some had intensified. Final domestic demand had eased back to 3.1% on a year ago from around 4%. Inventory building was stronger than expected and the Agents had been asked to delve further into that. Investment was weaker than expected. Both exports and imports were strong but they netted out overall. In the second quarter, industrial production rose 0.8% month on month in April. Manufacturing fell by 0.2% while retail sales grew 0.4% in May, though more had been expected after a weak April. Mr Vickers noted that the housing market was slowing but there was anecdotal evidence of a bounce back in lending in May. In the labour market, headline earnings growth had eased considerably to 5.1% in April, more than accounted for by the private sector, where both manufacturing and services fell back. He advised caution in looking at the numbers. Employment rose by 112,000 in the three months to April and unemployment was down 60,000 to 5.7%. Claimant unemployment was down 8,600 in May but the rate was still at 3.9%. Turning to prices, he said there were no great dramas in the figures. RPIX inflation rose 0.1 percentage points to 2.0% in May. He noted that import prices rose by 3.6% in May mainly because of oil, but also imported materials, taking the annual rate to 12.9% from 7.9% in April. Producer prices remained subdued. Mr Vickers drew Court's attention to the new Agents' score card and the regional economic reports in folders.

Mr Plenderleith said that at Court in May he had reported that sterling had begun to weaken a little. The good news was that this had persisted and the fall was shown in chart 1. Part, but not all, of the fall was against the euro. Sterling had also fallen back somewhat against the dollar. Since it had been hard to give rational explanation for sterling's previous upwards spike, it would not be wholly surprising that sterling was now reverting to previous levels, but it was not easy to explain why these movements had happened now. Whatever the reasons, they were welcome. Accompanying the movements was a softening of forward interest rate expectations. The market view was that the MPC might be less inclined to raise rates in future and that the data implied some slowdown of domestic demand. This implied that the market thought rates could be at or close to their peak with perhaps a further rise later in the year, and there was no immediate expectation of a rise as high as had been thought before. Whether that view would prove to be complacent depended on the data, what the US Fed did and market reaction to the minutes published that morning. The six : three vote would be something of a cold shower to the market. In response to a question from the Governor, Dr Julius and Professor Nickell said they had nothing further to add.

Sir Chips Keswick asked whether the Bank was being kept up to date by the committee examining the minimum funding requirement. Mr Plenderleith said the Bank was not involved. It was a report by actuaries to the relevant government department, and was very market sensitive. The Bank no longer handled debt management and could not claim an operational need to see it but had reinforced the message that it should be treated as market sensitive and that it should be published soon because of the uncertainty hanging over the market, as well as stressing, of course, the desirability of addressing the distortions flowing from the MFR. Mr Clark said that there had been discussions of the financial stability implications in the Financial Stability Committee of the Bank, the Treasury and the FSA.

Mr Bailie, commenting on inventories, said there was a hangover after the year 2000 and in Q1 they had been above the level desired. Mr Vickers agreed that there could well be an element of that, but it was not clear, and the sums might be changed by the ONS. It was hoped to learn more from the Agents and the ONS very shortly. Sir Ian Gibson noted that in Japan everyone was dubious about the economic growth numbers, as the Bank was. Sir Neville Simms, commenting on the construction industry, said output was very strong and had been so for a long time, and would continue so for the rest of the year. But orders were showing signs of dropping. The major forecasting bodies saw quite a thin year in 2002. This was the traditional pattern, and he expected a tailing off. In the next few months the industry would know whether that was happening for certain. He thought the Agents were slightly more bullish, and perhaps did not fully recognise the difference between output and orders. Turning to wages he said that the next three-year agreement was imminent in the industry, and the headline figure was 20%. This was a rebalancing between what was paid on hourly rates and what was taken home. It would produce a lot of headlines, but in reality the increase was 3-4% a year over the next 2-3 years. Mr Neill said that on the basis of the first 10 days results from the motor industry it was expected that there would be a 2-3% increase for the month and a similar increase for the full year, slightly better than expected at the beginning of the year. He noted the lack of profit in the industry, which was translating into demands on suppliers to reduce costs which would put pressure on pay settlements.

Sir David Cooksey said that the feedback from his companies' investments in computer hardware, software and services was that the good days up to the millennium date change could not be maintained. In at least half the companies there was a really substantial downturn, which was more than expected, and this would lead to less salary inflation in the area.
Ms Blow agreed, and wondered whether a lot of the spending on Y2K was well ahead of budgets so that companies were pulling back to where they needed to be.

Sir Howard Davies said that in the talking shops he attended there was a generally positive tone about continental Europe, where the risks were more up than down. There was a feeling that Japan would have very modest growth and there was a growing divergence of views about the US. The pessimistic view he heard was that, with unemployment at a low level in the US and even with an optimistic view of the Phillips curve, growth was significantly more than trend, leading to pressures in the labour market. So to offset that, growth needed to be significantly less than trend. Therefore the economy may need to slow to 1-2%, and if that happened, some of the growth in South East Asia, which was fragile, could tail off rapidly. He asked Mr King for his views. Mr King said it was difficult to be sure. It was too early to say if the US slowdown was significant. The difficulty was that having not raised rates early on there was uncertainty about the scale of increase needed. The current account deficit was large, heading for 5% of GDP, which was unprecedented in US history. The US was the biggest debtor in the world and at some point it was possible that the confidence of overseas investors in holding assets on this scale would be impaired. That could lead to sharp movements on the foreign exchanges and complicate the problems enormously. It could be that trend growth in the US would pick up but it was uncertain. The differences in estimates of trend growth could lead to differences of several percentage points in interest rates. Sir Howard Davies said that his impression from big UK and German institutions was that the number one risk scenario was a sharper slowdown in the US. Mr King said there could be two outcomes - the US slowing faster than expected or the Fed taking action. That was why the US was so keen to put pressure on Europe and Japan to fill the gap as their domestic demand slowed.

Mr Morris welcomed additional reports from the Agents. Mr Vickers, in response to a question from Mr Morris, said he would not make too much of the upward revisions to economy-wide growth. Trade was very volatile and while imports and exports had been slightly stronger than expected the net figure was roughly as expected. He noted the implications for imports and exports of lags and of decisions about plant locations. He believed some long-run trends were underway. On investment the best the Bank could judge was that overall in Q1 it was on the weak side but this was not true of business investment in aggregate. Within manufacturing, there was a very mixed picture. Dr Julius said she had attended a conference in Paris the previous week, attended by chief executive officers from the US and some from Europe. A number of Americans saw demand growth coming more this year from Europe than from the US.

FINANCIAL STABILITY ISSUES

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

Mr Clark said that Court would remember that at the time of the memorandum of understanding it was proposed that the Bank and the Financial Services Authority should set up arrangements for the exchange of staff. He noted that the Bank had a staff member going to the FSA on secondment and another would follow in September. It was hoped that there would be secondments from the FSA's side once the new regime had come into operation.

Turning to the Financial Stability Review, he noted that it would be published the following Thursday but that some of the articles would be trailed in advance at the beginning of the following week. Describing the FSR's overall assessment of financial stability conditions, he said that in the short term the situation had improved, partly because of the downward adjustment of asset markets and because there were some improvements in the situation in a number of emerging markets. But the two biggest underlying concerns were the possibility of a sharp slowdown in the US and/or a substantial fall in US equity markets, and the implications that would have given the high level of gearing in the US private sector, as well as for emerging markets; and questions about where Japan was going. He also drew Court's attention to articles on the dispersion of performance among companies in the UK corporate sector and the international exposure to risk of UK banks. Other articles discussed the pros and cons of fair value accounting in the financial sector, work on core principles for payment systems, and the implications of collective action clauses for country debt workouts. There were no questions.

FINANCIAL MARKET OPERATIONS ISSUES

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

Mr Plenderleith reported on the gold auction on 23 May which was 2¾ times covered. The price was in line with the market, and the quantity sold was absorbed fairly smoothly. However he had concerns about how robust the market was under the surface. The Bank had benefited in the auctions to date from producers adjusting their hedging strategies, and it was not clear that this would continue indefinitely. The scale of the auctions may begin to appear a little lumpy. The Bank had developed some ideas of how to respond if problems emerged. However it would prefer, if it could, to continue with the bi-monthly auctions.

Mr Plenderleith noted that the House of Commons Treasury Committee had been investigating the Government's cash and debt management. It had focused on the establishment of the Debt Management Office and its acquisition of the Bank's debt and cash management functions. It had also looked at the multiplication of agencies in these areas: the DMO, the National Debt Office, the Bank of England, with its banking facilities for Government, and also the Paymaster General, which carried out internal banking for Government departments. The remarks on the transfer were reasonably uncritical and there was no criticism at all of the Bank but the Committee had raised one question, which was whether there should be a single strategic banking agency to assume the functions of all the agencies including the work of the Bank. It was a reasonable question to ask. The Bank was one of the providers of services, as the Government's banker, and there was a question about why the others existed. However, if the issue was examined by the Treasury it might not start from that position.

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

Mr Clementi updated Court on Benefit*Select*. He noted that 12 members of staff had not signed. From 1 April there had been discussions with them and with the Union. By the Bank's calculations they were all better off. They had been offered the services of IFAs and some further inducements. Six had not signed, as of the previous week. The Bank had said from the start that there would be no grandfathering. Mr Clementi said he was very conscious of Mr Morris' remark last time when he said he stood behind the management but that management should be magnanimous. But the difficulty for the Bank was that if some of the existing staff were allowed to keep their old terms it would be anomalous and would go against all that the Bank had said. There should be one contract for all staff. The Bank had reluctantly reached the conclusion that it should terminate the contracts of the six who had refused to sign. They appeared to have decided not to sign as a matter of principle, encouraged by the Union. The case was now heading to a Tribunal. The six staff members and the Union would claim unfair dismissal. The Bank's defence would be that it had a strong business case, that it had consulted and that it had paid fair compensation. Even if the Bank lost it was not clear how damages would be paid because the new contract was at least as generous as the old. However, the outcome of Tribunal cases was always subject to some uncertainty. The Union was maintaining that the Bank was behaving vindictively. The case would be heard later in the year.

In response to a question from Sir Neville Simms, Mr Clementi said the Bank had given notice last week under the old contracts of three months' notice. Mr Neill said the silent majority would watch very carefully to see what the Bank management did. The Bank had gone very thoughtfully and carefully through the process, and must persist. The Governor said that was the Bank's view too, though with great reluctance.

Mr Clementi said there had been a long-running debate with the Lawn Tennis Association about building a national tennis centre at Roehampton. The Bank could co-exist with the LTA centre and receive a good revenue. Negotiations were at a delicate stage. The Bank had been very tough on the rent for the acreage that it would give up to the LTA. It was expected that

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agreement would be reached in a week or so. The LTA was very keen to announce it in Wimbledon fortnight.

Updating Court on BCCI, Mr Berkowitz said that the House of Lords judgement in May had been very satisfactory from the Bank's point of view. The House of Lords dismissed the liquidator's claim based on European law and decided that its view was so clear that there could be no recourse to the European Court of Justice. This was very important because in a claim under European law no state of mind had to be proved. The Court also substantially approved the tests for misfeasance in public office set by Mr Justice Clark at the first hearing in the High Court. The other side would have to show the Bank acted in bad faith and that it knew its actions were unlawful and would probably cause loss to depositors. Subjective recklessness could amount to knowledge. The Bank's advisors were pretty satisfied that if the matter went to trial the Bank would have a very strong defence and should succeed. At present the Bank was trying to avoid going to a trial. There would be a hearing on 23 October. The House of Lords had allowed the plaintiffs to amend their statement of claim for the ninth time. They would then see if the allegations met the test for misfeasance. If they did there would be a second leg, in which the plaintiffs would seek to overturn the Court of Appeal's decisions to strike out the allegations. The Bank would set out to show that there was no prospect of the claim succeeding, in the hope that it would be dismissed, as it had been in the High Court and the Appeal Court. Court took note of Mr Berkowitz's report.

MANAGEMENT OF THE BANK - 2

Counterfeit Notes
(Executive Directors together with Ms Lowther and Mr Jarvis in attendance)

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[redacted]

[redacted]

[redacted]

Printing Works' Annual Report
(Messrs Clark, Plenderleith, Vickers and Jarvis in attendance)

Mr Jarvis presented his Annual Report to Court. In response to a question from Mrs Heaton about a decline in the number of bank notes produced, Mr Jarvis said the peak was 1.4bn recently, though the absolute peak had been further back in the 1970s when it was 2.2bn notes. The decline in numbers was partly because other means of payment had been developed, but largely because of a trend to higher value notes, encouraged by their convenience for ATMs. In response to a question from the Governor about Debden Security Printing, Mr Jarvis noted that the company was inhibited from competing against De La Rue. It was offering its services as a sub-contractor. He noted the success of sales of machine readable thread, which was incorporated in Mexican bank notes, the contract for which had been renewed. DSP was making sensors for note sorters for Finland and was talking to Belgium and Spain. There was some spare capacity in ink production and some possible sales were being pursued. He noted that Court would discuss a strategy paper on the Printing Works the following month.

Distribution of Court Papers
(Executive Directors together with Messrs Bennell and Higgs in attendance)

The Governor thanked Mr Neill, and his colleagues at Unipart, for their contribution towards the paper submitted to Court.

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Mr Clementi said the paper looked at how to get dossiers to Court Members electronically. He asked Mr Neill to thank Phil Vickers for his particular help in looking at the issue. The paper put forward two approaches to decryption and the Bank would like to try both. They would like the authorisation of Court to pursue a pilot project for three to four months and would like three or four volunteers, using different systems at their end to see how they worked. In answer to a question from the Governor, he said the pilot would be run in parallel with a paper based system. In response to a question from Ms Blow, Mr Clementi said that Directors' own staff might have a view of the degrees of security the Bank had suggested. Ms Blow said hacking into mail boxes was very common and they were as vulnerable as briefcases left in taxis. Sir Neville Simms said he did not believe three to four months was a long enough trial for security purposes because it was unlikely that there would, in that time frame, have been an accident. Sir Ian Gibson noted that the Inland Revenue had insisted on committed ISDN lines into homes which could only be accessed at home. He suggested consultation with the Inland Revenue to establish if there were broader standards, in case there were criticisms. The Governor said this was a good point and it could be pursued in the trials.

Baroness Noakes said the trials were about cost shifting not cost savings and she was very concerned about the implications for the recipients. A secretary would be tied up printing out the papers. They were not papers that she read on the screen. She was very sceptical about whether there were advantages for meetings of this kind, and she was not convinced that this was the way forward at this stage. Sir Chips Keswick said he supported Baroness Noakes. Sir Neville Simms said that that issue could be included in the trial.

The Governor said it seemed to him that it was worth exploring. Sir Ian Gibson noted that he and John Neill could not do business at all without their mobile laptops. Mr Neill said that screen-based communication was going to be basic in business, but people were at different stages of development. He said he would also encourage Bank staff to present information so that it would be easy to digest on screen. Mr Clementi said that was a very good point. It should be made clear to producers that their documents would be seen in electronic form.

Baroness Noakes asked whether the information was for use on screen or for printing out. Mr Clementi said it was primarily for the second purpose but many Members of Court travelled

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a lot, and having remote access to their papers would be useful. The Governor said the Bank would report back to Court.

Domestic Matters
(Executive Directors in attendance)

The Governor advised Court that following the departure of Messrs Allsopp and Hawker, it was appropriate to consider revisions to the membership of the Standing Committees. He suggested that Mr Neill move from the Audit Committee to the Remuneration Committee and that Sir Brian Moffat and Ms Blow join the Audit Committee. The continuation of other members on the two Committees would be taken as read.

Court APPROVED the revised memberships.

19. vii. 00

19. 7. 00

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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 JULY 2000

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

Sir Ian Gibson
Ms O'Donovan

The Governor said he would extend a warm welcome to Sir Brian Moffat when he arrived for his first Court meeting but he had just received a message that Sir Brian had been delayed by a serious train incident. [Sir Brian arrived for the Printing Works discussion]. He also noted that there would be a farewell lunch for Mr Hawker after Court.

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

MONETARY STABILITY ISSUES

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

In presenting the monthly MPC Report to Court, Mr Vickers noted that rates had been unchanged in July and the minutes published that morning showed a unanimous vote of 9:nil. The international data showed that the US was slowing and the question was whether a soft landing was in prospect. US consumer prices grew by 3.7% in June on a year ago but core inflation was lower. Euro area growth was on track. GDP for Q1 was revised up to 0.9%. The harmonised CPI was up 2.4% on a year ago in June, 0.5 percentage points higher on the month on account of oil, but core inflation had risen by 0.2 percentage points as well. The main question in Japan was whether it was likely to end its zero interest rate policy. Rates were not changed last time. The Tankan had risen to -18 in June from -23 in March.

In the UK, first quarter growth remained at 0.5% but the balance was changed somewhat, with investment much weaker and other factors offsetting this. For Q2, the preliminary estimate of GDP would be available on 21 July. The best guess was that it would look similar to, or a touch stronger than, Q1. The National Institute estimate was 0.8%. This was partly because industrial production rose 0.1% in May on a month earlier and manufacturing rose by 0.4%. House prices weakened in June although the picture was mixed, while retail sales were slightly firmer. Cars were still weak but consumer confidence was broadly flat though above the long run average. Household credit growth was still strong in May but was broadly stable at around 10% on a year ago. The British Chambers of Commerce survey showed a weakening picture in the second quarter from manufacturing, contrasting with a strengthening picture for services. Investment and employment indicators were reasonably positive. Mr Vickers said that the Bank was analysing the consequences of the Government's Comprehensive Spending Review.

Turning to the labour market, he said pay growth was benign compared with previous expectations while the quantities data was quite firm. Unemployment continued to fall. The claimant count was the lowest for nearly 25 years. Turning to prices, he noted that input prices rose 14.1% in the year to June, jumping 1.4% on a month ago because of further rises in the price of oil. Output prices rose 0.5% in June on the previous month driven by oil and other products like metals, pulp and paper. He noted that annual RPIX inflation rose to 2.2% in June while RPI inflation at 3.3% was higher because of interest rates and the abolition of MIRAS. On the harmonised index, inflation was 0.8%, which was well below the euroland rate of 2.4%. Goods prices rose by 0.7% in the year to June while services rose to 3.5%, a very wide gap, but not as wide as it had recently been.

In response to a question from the Governor, Dr Wadhwani and Dr Julius said they had nothing to add.

Mr Plenderleith said it was a month of little movement. The market had watched as the ECB, the FOMC, the Bank of Japan and the Bank of England had decided not to put rates up. He noted that sterling had come back from its spike but had not fallen further and remained at about 105 on the index. The euro, having pulled out of its nose dive in mid-summer, had in fact softened further. Turning to interest rates, he said that the market took the view that there was some possibility of a slight further rise in UK rates in due course, but not a very large possibility, and not a very large rise. There were indications of the market preparing to go into its normal summer torpor.

Ms McKechnie described the Consumers Association quarterly trends survey. The headline rate was the most confident since the survey had started in trial form two years ago. Even Scotland was showing an improvement in confidence. Inflation expectations were also the highest since the start of the survey which showed falling expectations on house price inflation. The previous time expectations in the South East had been of 6.1% inflation but this time the rate had fallen to 3.8%. There was also the lowest level of precautionary savings apart from last January. She also noted the reference to second-hand car prices in the Agents' Report. She said there was no great connection between new and second-hand car prices but the campaign on new car prices had had a very significant effect in the second-hand market. People were staying away in general from buying cars, and not just new ones. About 40% of new cars had been pre-registered and would come onto the market at a significant discount. Motor Trader magazine had said that personal imports would run at 300,000, which she found difficult to believe. In response to a question from Dr Julius about whether there would be a bounce back in car sales once the DTI had made up its mind on the competition issue, Mr Neill said business purchases were up dramatically though he noted that there was a possibility of misclassification. The industry was convinced that, as soon as the DTI made its response, consumers would start to buy again, though not immediately. Customers were waiting to see if prices would come down but expectations were exaggerated, and 30-40% reductions were not going to happen. He noted that there had been huge hype about internet sales of cars but the actual numbers were very small. The industry felt it was being hit by a sledgehammer at every level. Ms McKechnie said the Consumers Association economist felt that the real price effect would only come at the end of the block exemption. Manufacturers would set up their own outlets or string out price differentials until the market forced them to change. She could not say which one of these would be the outcome.

Mr Buxton said that unsecured borrowing was still rising at 14.5% and secured borrowing in June at 8.7% was still high. Corporate borrowing was rising fast although this might have more to do with the fact that money was not being raised in the bond market than with strong activity. Across the corporate sector there were huge variations in activity. Confidence was down but at the SME level it was going up a bit.

Sir David Cooksey said that earlier in the year he had warned about the ridiculous quality of some of the companies floated on the Stock Exchange. A little later there had been closures in the e-commerce business. What was now happening was a real sign of market appetite coming back for high quality new issues in the technology sector. Initial public offerings were succeeding that would not have three months ago.

Mr Bailie said that complaints in industry had changed into grumbles. The recent fall in the pound had helped. The biggest area suffering with the exchange rate was tourism. Television advertising was very buoyant reflecting confidence in the economy. Labour pressures were benign. The print and packaging industry was under some pressure from the Inland Revenue over the interpretation of the meaning of long life assets in relation to printing presses. If that argument were sustained, which was quite difficult, it would apply in fact across manufacturing and could have a huge impact on corporate cash flow. The issue was being fought extremely hard by the industry. Turning to the trade balance, he asked why he had not heard this discussed seriously for a long time. Mr Vickers said that there had been over recent years a considerable deterioration of net trade which detracted from GDP growth. But it was puzzling how strong UK exports had been, at least in some export sectors.

Non-policy meetings of the MPC
(Messrs Clark, Vickers and Plenderleith together with Drs Julius and Wadhwani in attendance).

Mr King said there had been two meetings, both important: one was on the forecast process, where the MPC had agreed to focus its discussions better on big issues. It had also wanted to give more emphasis to the judgement of risks. Recently discussions had concentrated too much on the central projection. The MPC had agreed to a process started later with fewer meetings which forced it to focus on the big questions. Secondly there was a meeting to discuss the MPC's media strategy. The Bank's public Opinion Polls had revealed a lack of understanding about how interest rates affected inflation. The MPC agreed that this needed addressing through speeches and other forums. There would be a more detailed account of the polls for Court in the autumn.

FINANCIAL STABILITY ISSUES

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

Mr Clark said there were two main developments. Asset price volatility and particularly equity price volatility had declined significantly, and in a number of emerging markets the picture continued to improve though in most there were some underlying issues that remained to be resolved. For example Argentina and Brazil still had debt structures that made them vulnerable to sharp movements in interest rates and exchange rates. He noted that Mexico had a new President and government party and there was some uncertainty about what economic policy would be. However, the immediate reaction had been a strengthening of the peso. He noted the IMF mission to Russia and said there was a possibility of a new programme being negotiated in the autumn. Turning to Poland, he said the Government had collapsed recently leading to significant capital outflows and the Bank was watching closely the position of the banking sector in Poland. The US and Japanese prospects remained critical to the outlook. [Sir Neville Simms arrived].

Mr Clark said that the Bank of England was working with the Bank of Canada to put together a framework for handling systemic financial crises. This was to ensure that the issue did not fade from the agenda, and to explore various ways of mounting an orderly approach. Mr Clark also noted the publication of the Financial Stability Review and said there was a helpful and supportive reaction in the press and also from other Central Banks.

FINANCIAL MARKET OPERATIONS ISSUES

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

Mr Plenderleith confirmed the transfer of the CGO gilts settlement system to CREST.

Mr Plenderleith also reported on the latest gold auction. As he had noted at the previous report to Court in May, he had at the time been somewhat concerned that the market was thin. That pattern had continued. The auction in July was only covered 1.4 times and the price was $3 less that the fixing price on the morning, though in fact it was in the middle of the trading range of the market over the previous month or so. This did indicate quite a thin market. The Bank would continue to consider whether bi-monthly auctions were the right pattern and would keep that under review.

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

The Governor advised Members that a large birthday card, in the form of a £100 note dated 4 August 1900, would be sent from the Bank to HM Queen Elizabeth the Queen Mother to wish her a happy 100th birthday. The card would be outside Court if members wished to sign it.

The Governor also reminded Members that 'Governor's Day' was the following Sunday at the Bank's Sports Club in Roehampton and he hoped as many as were free that day could attend with their partners.

[redacted]

MANAGEMENT OF THE BANK

The Future of the Printing Works
(Messrs Clark, Plenderleith and Vickers in attendance)

The Governor said that last December Court had reviewed three options, and it was decided that the review team should carry out further work on the proposals before any negotiations commenced. [redacted], had been commissioned to produce a report and an executive summary which together with a covering note from Mr Clementi had been sent to members of Court the previous week. He invited Mr Clementi and Mr Bailie, who was a member of the review team, to comment on the details for consideration.

Mr Clementi said he was extremely grateful to Mr Bailie who had spent a great deal of time on the review. He noted that there had been some criticism of [redacted] report among colleagues in the Bank and some of that was merited. He was not sure that the risk assessments were entirely consistent. But the report as a whole was worthwhile in that it identified the main issues and arguments. The main argument was that printing was a separate process from design and issue of notes and was not a core central bank function. This issue had become more acute because of shrinking demand, and it was clear to the workforce that without more orders the business would continue to reduce. For years there had been constant downsizing and this would continue. The Review Committee felt that if the Bank went down that route of competing with the private sector it would be better to do it through a private company. There was considerably more work to be done before going down the recommended route but the Bank wished to put to Court the work that had been done to date.

Mr Bailie said that when Court last met there was a suggestion of an arrangement with De La Rue, which the Review Committee had looked at. But De La Rue did not wish to give the Bank production of 700 million notes if privatisation were off the table.

There were three issues: should the Printing Works stay as it was, which might be a legitimate outcome; should there be corporatisation; should there be privatisation. The first option produced the same problems as now. The second option would only be worthwhile if there could be a reduction in unit costs, but the question was whether the Bank of England was equipped or structured to go into a commercial printing exercise. He believed therefore that there were two practical choices, since C(1) was not an option and had not worked with Debden. Of the two practical options, staying as we were would be a loss of opportunity. Jobs would continue to disappear. He did not believe the Printing Works could continue to reduce unit prices and he suggested these would rise as output went down. It could also suppress opportunities for employees. The remaining option was privatisation.

The Governor commented that he found the report extremely unpersuasive: there were a large number of inconsistencies and it was biased and assertive in its presentation. He pointed to examples of inconsistencies. He also believed that there was a biased presentation of the executive paragraph on page 1, referring to an examination of other central banks around the world. There was no mention that France, Belgium and Italy did what the Bank of England did or that the US and Japan printed their banknotes within the public sector. There were three key issues which were not focussed on adequately in the Report. The first was cost, the second was security and integrity of the note issue and the third was the future of staff. He said the Bank should have had a more intensive discussion in the executive before bringing the Report to Court. But there had been no time to do it properly. There should now be a proper discussion in the executive. As far as he was concerned he was not at all persuaded that privatisation was the right way forward. This went fundamentally to the reputation of the Bank in terms of the security and the reputation of the note issue. He was not prepared to take any risks with that unless he was persuaded that the cost impact and the advantage to staff outweighed any risks on the security and integrity front. Court should know that this was not agreed within the executive.

Mr Plenderleith said that he too had serious problems with the Report, not just with its incoherence but also with the orientation of the debate. It focussed only on production and not on the wider note issue function as a whole, which indeed the review had not been asked to do. Because it focussed principally on production it focussed on cost minimisation. But, in terms of the central bank's responsibilities for the note issue as a whole, there were two objectives, cost minimisation and the maintenance of standards of security and distribution. The Bank was aiming all the time at the right balance between these two. Privatisation would very likely lead to less direct control over the second of these. In that event, if the Bank went to privatisation, the last thing he would wish to do would be to lock into one private supplier because the Bank's bargaining position would be extremely weak. So under privatisation the Bank would have to consider the flexibility of choosing the best supplier, in other words outsourcing. Therefore the first question to be addressed should be whether the Bank was prepared to contemplate outsourcing. There were considerable difficulties because the standards had to be very high indeed and the outsourced supplier would look to charge accordingly. So there was a real question whether it would be possible to reach a reasonable agreement on outsourcing. On this, he had an open mind, but the issues were not addressed in the current study. Mr Plenderleith said it seemed to him that the Bank needed to assess two alternatives: it could stay as it was, recognising that it was not necessarily the cheapest form of production, while taking the production of seven hundred million notes a year from Gateshead if that could be negotiated, or it could address the question of outsourcing. If it were agreed that that could be done, privatisation might be the consequence, but it was not the first step and not something to be addressed on its own.

Mr Bailie said it was unfair to suggest a bias in the consultation. Privatisation was not mentioned until two months into the work on the Report. The Governor noted that privatisation was not in the original terms of reference. Mr Bailie agreed. But Mr Bailie said privatisation was the conclusion the consultant had come to. Mr Bailie's view was that the options were to stay as now or to go towards privatisation, whether or not through the route of corporatisation. The issue was whether the same services or quality could be guaranteed, whether or not the Bank owned the process. Mr Bailie's view was that that was possible. As for the protection of jobs, the least secure future was the status quo. The Review Committee would take into account the view expressed.

Mr Buxton said that in the circumstances he did not believe the Report had been discussed enough in the executive, and he did not believe it right for Court at this stage to enter a discussion that was going to be acrimonious. He believed that the review should be taken back to the executive which should come back to Court again. The Governor agreed, and said it would be some months before it came back to Court. Sir Chips Keswick agreed with Mr Buxton. Sir David Cooksey said Court was not seeing this in sufficient context. He would like to see projections ten to fifteen years ahead of the likely note issue in the context of the impact of electronic money. He was also unconvinced by the argument that the issue and return of notes should stay within the Bank if the argument for privatisation were accepted.

Ms McKechnie said she agreed with Mr Buxton. In answer to her question about who made the decision and whether the Treasury knew of the discussions, the Governor said the decision was for Court and he did not know the Treasury view. He knew that they had no plans to privatise the Royal Mint.

Baroness Noakes said she agreed with the Governor on the unimpressive nature of the financial analysis by the consultant but she did believe the Report gave a solid sense of direction. The status quo was difficult to justify. The Bank owed it to the Printing Works to chart some way forward. That could be to commercialise it into a business or to say that the Bank did not wish to devote time and energy and money to banknote printing, in which case privatisation would be the more valid route. So the report focussed on what the Bank should do about it. It was possible to attain adequate security and to have access to quite complex operations outside your own ownership or control. She hoped the Bank would get to the position where the status quo was not an option and it would seek the best action.

The Governor said the report did not justify the conclusions on the basis of the analysis done. In particular the issue of jobs had to be reviewed very much more carefully before the Bank could come to a conclusion. On security, there also had to be a much more careful examination, because this was a very particular product and the Bank's reputation was intimately bound up with its quality. There should be a very careful examination of how and why others had privatised and why others had in contrast taken the view that they were not willing to take that security risk. A lot more work had to be done on the costs, on security and on the future of staff, taking account of Mr Plenderleith's points and also of the points made around the table.

Mr Morris agreed with Mr Buxton and said that clearly the discussion first had to be within the executive. Wherever the discussion took place, Court would have to re-visit it. He noted that Directors had had a discussion over dinner two nights before about morale and he asked if morale at the Printing Works would be considered. He also asked whether staff at the Printing Works had been consulted or whether they knew about the discussions. Uncertainty would not help morale. The debate should be brought to a rapid conclusion or the staff should be involved.

The Governor said that the option of privatisation had not been in the terms of reference but had been added to the discussion with senior management. He did not believe the pressure that generated should dominate the decision. Mr Clementi said he did not believe the Printing Works staff as a whole had been included in the debate. The position was that senior Printing Works management had changed its views over three years. When he had arrived in the Bank they were concerned that he intended to privatise the Printing Works. Now senior Printing Works management was of the view that there should be privatisation, since their concern was now that, if the status quo was maintained, the Printing Works would continue to shrink. Mr Neill said that whatever option was chosen the Bank should make very clear that it expected quality to increase and costs to come down. He noted that there were clear views among the executive. Any options brought forward must demonstrate how the essentials must be met. There were ways of achieving what was wanted in almost all scenarios, but that must be demonstrated.

The Bank in the Community
(Messrs Clark, Plenderleith, Vickers and [redacted] in attendance)

In presenting her report to Court, [redacted] said the paper aimed to give members of Court an idea of the Bank's community involvement programme, draw conclusions and look to the development of the programme over the next year. The Bank's community involvement policy was due to be reviewed by Court in 2001.

[redacted] said she had invited BITC to review the Bank's policy. They were impressed by the amount the Bank did and their main observation was that a policy document should be produced focusing on core activities that could be used both internally and externally. [redacted] also mentioned that she would use BITC's "Principles of Corporate Community Investment" as a measure to help ensure the Bank's programme was effective. She drew attention to community involvement being used as a staff development tool. For the first time voluntary work was being promoted to develop staff, helping them improve skills such as communication and management.

[redacted] noted that, during the year 1999/2000, the Bank had contributed £568,000 (0.45% of pre-tax profit) in support of its community programme. This was a reduction of £385,000 on the previous year's figures, mainly due to the drop in staff secondments to voluntary organisations, which as a matter of personnel policy were being phased out. The year was a particularly good one for staff fundraising. The Children's Promise was the charity of the year and staff took part in the Final Hour Appeal raising over £14,000. Staff also took part in a wide range of other fundraising activities and the Bank matched all funds raised.

[redacted] said that for the Bank's Millennium Project she had asked The Runnymede Trust to carry out research into good practice in mentoring between school children and business people. The findings would provide the basis for a best practice guide that would be disseminated UK wide.

She also highlighted how Bank staff played an important role in raising educational standards through taking part in a number of activities at Osmani Primary School, Whitechapel. During the year the record of many successful partnerships had led to the voluntary sector seeing the Bank as a useful ally in helping to disseminate best practice. [redacted] noted that, although the Bank contributed a relatively small amount by way of donations, it supplemented this by contributing gifts in kind.

The Governor thanked [redacted] for her report. Ms McKechnie, who noted that she had been Executive Director of Shelter, said it was an incredibly impressive programme and she gave her congratulations to all involved. She noted the advantages, when dealing with small groups without the resources to tackle complicated applications, of setting aside a fund of perhaps £20,000 to be given out in dollops of up to £250 on the basis of evidence of a properly run bank account.

Mr Morris agreed with Ms McKechnie's commendation of the report. He said that for the Bank to have a creditible community programme the first question was whether the Bank looked like the community it served. He noted that he had raised previously the question of the Bank's employment policies and that a report on the subject had not come forward. The Governor said the Bank would make sure the report on employment policies did come forward.

Ms Blow said that [redacted] report showed a very impressive record. She asked whether it was possible to measure the impact of the programme on staff morale. [redacted] said that there was an effect on morale which depended on the context. She said she tried to sell the programme as something the staff were doing for the community. Sometimes the activities were distanced from the organisation. If morale was low staff may not see themselves as carrying out these activities for the good of the Bank but would rather see the purpose as simply for the good of the community. She believed that the programme did raise morale in the Bank. There were schemes where the staff did their own projects and the Bank contributed. The programme worked on a number of different levels.

In response to a question from Ms Blow about whether it was possible to portray the Bank as an enabler, [redacted] said that some publicity was planned soon and that point would be taken on board.

Mr Neill declared an interest as a board member of Business in the Community. He congratulated [redacted] on the work she was doing. The fact that the Bank was so pro-active sent a very good signal to corporate UK. He said he would be interested to see if the Bank could enter for community awards and to win would send a wonderful signal. Sir Neville Simms noted the change in the cost of secondments. He noted the particular value for staff of short to medium term secondments. He said it was an excellent report. In response to a question from Mr Stretton about why secondments had stopped, [redacted] said that it was more for Personnel than Secretary's reasons. Traditionally secondments were exit jobs.

The Bank's Property Strategy
(Messrs Clark, Plenderleith, Vickers, Midgley and Pennington in attendance)

The Governor said that there were two papers to consider related to the Bank's property. The first provided an update on the property portfolio and outlined plans for particular buildings and the second concerned the refurbishment of the ground, mezzanine and first floors of Head Office. Mr Pennington noted that Court proceedings in 1998 referred to the sale of one or two properties in the City, and Court in January decided to sell New Change. He described his paper on the Bank's property portfolio to Court.

Sir Howard Davies said that having had some familiarity in the past with the issue, the paper seemed sensible to him, and in particular it was sensible to cut losses at Southgate House. He asked whether the proposals for Debden included a read - across to the paper on the future of the Printing Works. Mr Pennington said the proposals were not mutually exclusive.
Sir Neville Simms said he was not a great believer in re-painting the kitchen before selling the house. He asked whether in the case of Roehampton the Bank would take a development partner to take a development risk. Mr Pennington said that a development partner was something the Bank would wish to look at. Sir Neville Simms recommended that there should be no downside in the development for the Bank. The alternative would be to wait until the market was ready at which point a developer would almost certainly approach the Bank. In response to a question from Baroness Noakes, Mr Pennington agreed that contingent office space would be left unused and would be equipped with services but not with IT, because that dated too quickly. The space would have room for two hundred. Baroness Noakes suggested that might be wasteful. Sir Neville Simms said that firms offered contingency space as a service. It was basically a cost equation and Court should see the comparative.
Mr Plenderleith said that the contingency space would be a small part of what the Bank had. It had a substantial allocation of space for this purpose at Canary Wharf. Sir Neville Simms said that the proposal in the paper did not appear to be a very large allocation of space.

Mr Pennington then described his paper on the new project for the refurbishment of the ground, mezzanine and first floors. In response to a question from Mrs Heaton he said that the area of the CGMO refurbishment three or four years ago was of approximately the standard the Bank was looking at for the new proposal. It was necessary to put in higher quality services. The end product would be a very comfortable working environment. The difference compared with the HORP project was mainly in the air conditioning.

Mr Stretton asked what were the possible costs that had not been allowed for. Mr Pennington said that the Bank was extremely solidly built. The downside was that this could raise the amount of work necessary to do simple things. Also, when the Bank was built, asbestos was used and this had never ceased to come out of the walls. The proposals assumed that it would be worse this time. Sir Neville Simms said the paper was rather pessimistic about out of hours working. A lot of the industry had to work out of hours. He also urged a degree of forethought about the problems posed by the solidity of the Bank's structure at the front end of the project planning stage. He believed more could be done out of hours. He found it very difficult to say that the Bank should not go ahead with the full refurbishment of the floors. It still had time to negotiate more working out of hours and he would support some additional costs for that purpose, so the Bank did not have to have another eighteen months or two years of disruption. He also asked for a further explanation of the fees. The Governor noted that the proposal was to restrict noise at least to current levels and he said that the emphasis had to be on "at least". Mr Pennington said that if all work was out of hours he was not sure whether the Bank would receive value for money because of the effect on productivity and it ran the risk of not meeting the timetable. Sir Neville Simms said that if productivity was unsatisfactory then the contractor should be removed from the job and another one found.

Court was content with the refurbishment proposals.

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

Mr Midgley drew Court's attention to the fact that income was ahead of budget by £2.7 mn and expenditures were £8.4 mn below budget. The largest contributing factors to the former were higher than assumed interest rates and a continuing higher level of customer deposits, while half of the latter shortfall was accounted for by investment spending below budget and an increase in work in progress at the Printing Works. Sir Chips Keswick said that the gilts desk had done extremely well. Mrs Heaton noted that the project status reports in a number of cases had a shared responsibility at senior level. Mr Midgley said this was fair comment.

Appointment of External Auditors
(Messrs Clark, Plenderleith, Vickers and Midgley in attendance)

Introducing his paper to Court, Mr Clementi said that on balance PricewaterhouseCoopers was preferred. Court was content with the reappointment of PricewaterhouseCoopers as Auditor, with the intention to review the position in 2004. The Executive Directors withdrew.

AL5

Revised Guidelines for MPC Members
(No visitors)

The Governor invited Court to take note of the revised MPC guidelines. He said the changes were mainly minor matters of drafting and were acceptable in their current form to MPC Members. Court took note of the guidelines.

Successor to Mr Vickers
(No visitors)

The Governor said that the Bank was exploring the possibilty of appointing Charles Bean of the London School of Economics as successor to Mr Vickers. The Chancellor was content and would accept Mr Bean. The Principal of the LSE was prepared to allow Professor Bean three years leave of absence. But it was understood by Professor Bean and himself that his intention would be to stay on. Three years had some bearing on LSE's external financing. The Governor said from his own point of view the reality was that if after three years Professor Bean was not enjoying the job he would resign anyway. Precise terms had not been discussed in detail but he had outlined the pay structure and the benefits approach to Professor Bean. The details could be discussed with him later in the week. His contract would go to the Remuneration Committee for consideration. If Court were prepared to approve this appointment as Chief Economist and Executive Director then the Bank might be in a position to announce it at the end of the week before Professor Bean went to Australia for a month. He drew Court's attention to the papers before them on the role of the Chief Economist and Executive Director, the key responsibilities and the objectives for Mr Vickers for the current year. He hoped Professor Bean would arrive in the Bank in the second half of September. On the whole he was content with the role as defined. In response to a question from Sir Chips Keswick about whether the Treasury Committee would be told in advance, the Governor said the Committee would not be forewarned of the announcement.

Court was content with the appointment of Professor Bean as Chief Economist and Executive Director and member of the Monetary Policy Committee.

Court ends.

16 August 2000

16 August 2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 16 AUGUST 2000

Present:

The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr King, Deputy Governor - Monetary Policy
Mr Bailie
Ms Blow
Mr Buxton
Sir Ian Gibson
Mrs Heaton
Ms McKechnie
Sir Brian Moffat
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Sir David Cooksey
Sir Howard Davies
Sir Chips Keswick
Mr Morris
Ms Kathleen O'Donovan

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

MONETARY STABILITY ISSUES

Inflation Report together with the economic and monetary discussion, incorporating the monthly MPC Report to Court
(Mr Allsopp in attendance)

Mr King said that the MPC minutes revealed the vote in August had been very close and this provided a full explanation of the Inflation Report fan chart which showed the inflation forecast to be slightly above 2.5% two years ahead. There had been a number of questions about the forecast being above the target two years ahead at the Inflation Report press conference.

The forecast and the vote showed the MPC was at the margins between unchanged and increasing interest rates. Mr King said that overall the economic news was very good, with continued growth alongside low inflation. But the imbalances underneath the aggregate picture remained an issue. On the demand side, domestic demand remained strong relative to net export demand; on the output side, services were more buoyant than large parts of manufacturing; and in terms of prices, services prices inflation was high while many goods prices were falling. The view of the MPC was that these imbalances would have to subside if the inflation outlook was to remain benign.

Mr King said there were no real concerns about economic growth looking ahead. Chart 6.1 in the Report showed growth was forecast to be at or around its long-term average rate over the next two years. The inflation forecast, on the assumption of unchanged interest rates, was for the RPIX measure to fall as the effect of higher oil prices unwound and then rose in the second year. But the profile overall was remarkably gentle compared with the past. It was slightly higher than in May, reflecting a lower exchange rate, slightly weaker growth in consumer spending, and a more benign view of the labour market.

The impact of the Government's Comprehensive Spending Review was considered to be small overall relative to the position outlined in the March Budget. Spending would be marginally higher than envisaged in the May forecast, reflecting the carrying forward of the previous year's underspend. There were some uncertainties looking ahead. The effects of the switch towards more direct expenditure and away from debt repayment was not clear and something the MPC would need to monitor. In the opposite direction, HMT had advised the MPC that there was a risk that actual spending might not reach the planned levels. Taken together, the MPC felt there would not be much net impact on inflation.

More generally, there were risks on both sides of the inflation forecast. Growth in the world economy remained strong and this year it was expected to have the fastest growth rate for 12 years. There remained a downside risk from lower world activity. But there was an upside risk that domestic demand might not slow as much as the MPC assumes. A period of consolidation was expected, with both the growth of income and wealth expected to slow. Consumer spending was expected to grow below its trend rate as balance sheets stabilise. The oil price had increased since the August Inflation Report, as had the exchange rate. In relation to pay, Mr King said that the MPC had been cautious throughout this year in reading too much into the earnings figures because of the potential distortions resulting from Millennium effects. The latest labour market data showed a further fall in unemployment – the LFS measure was now at its lowest ever rate at 5.5% – and a rise in employment, alongside a fall in 'headline' earnings growth to 4.1%. There was a large negative impact on average earnings in June from bonuses, around 20% lower than the previous year. June was not a significant month for bonuses so this effect might prove temporary. Nonetheless, the data continued to show the labour market tightening but few signs of earnings growth rising. This gave the MPC some comfort but also raised questions.

The differences of view within the MPC were again outlined in Table 6.B of the Inflation Report. Those highlighted in August related to different assumptions and expectations about productivity growth and pressure on margins. There were other differences within the forecast but these only resulted in marginal differences at this time.

Mr King also drew Court's attention to the box on the MPC's forecasting record. This was an annual exercise, although the MPC assesses its forecast errors as part of the quarterly process. To date, the MPC had under-estimated output growth and over-estimated inflation. However, there were only four observations and so it made no sense to draw any conclusions from this result. Over time, more observations would make the exercise more useful. Mr King said it was difficult to undertake an overall audit of the MPC's forecast as everything turned out different than forecast to some degree or another. However, differences in the exchange rate from the profiles assumed by the MPC more than accounted for the forecast errors overall. He said there was no evidence of systematic bias in the MPC's forecasts.

Turning to market developments, Mr King said there was little further to note. He said the partial recovery of the euro had been reversed over the past few weeks and oil prices had risen again.

Sir Neville Simms commented on the earnings data. He said increases in the construction sector were running into double figures though wage settlements were not the main source of the increase. Labour shortages, most recently in the railway engineering sector, were bidding up rates of pay. Mr Neill said large wage settlements in the services sector contrasted with settlements below inflation in parts of the manufacturing sector. In many cases, unit wage costs were falling as employers switched to new contracts with flexible hours. He said pay in the IT sector was rising fast, reflecting a global shortage of staff related in particular to the strength of the US economy. Mr Allsopp asked how this related to a lack of wage inflation in the US. Mr Neill suggested productivity improvements were often dramatic which meant unit costs were falling. He felt the technologies being employed by US firms would shortly impact on the UK. He added that the retail car market was strengthening as deal prices rather than list prices, were falling, but fleet demand was less buoyant.

Mr Bailie said labour input and unit costs were falling across industry. Firms were content to achieve prices in line with the year before. Many customers were seeking price reductions. In this environment, unit wage costs needed to fall and the need to fund wage increases with productivity improvements was well understood by unions. He also said there was some concern that there were expectations that increases in government spending would enable higher public sector pay increases. There was a danger that funds would go into higher revenue costs rather than investment. In relation to the Northern Ireland economy, he said skill shortages reflected the booming economy in the Irish Republic. This was putting a strain on some firms' costs. The overall economic picture was fairly benign, with the exception of the impact of the high value of sterling.

Mr Stretton commented that the Scottish economy had mirrored England over the recent past but the figures for the first quarter of the year had shown a fall in GDP in Scotland. Although he felt this was probably just the usual volatility quarter-to-quarter, and was not reflected in the tone of the Agent's Report, it had led to a debate about recession in Scotland.

Ms Blow suggested that bonus payments in the IT sector would be lower this year than last. Many had reflected Y2K-related work. A number of companies in the sector had issued profit warnings which would constrain bonus payments this year. She also noted that firms were having to pay higher salaries to attract employees with new technology skills without always knowing how they would be used or absorbed into businesses. Companies were still working out how to utilise new technologies but by next year she felt these issues would have come to fruition.

Sir Ian Gibson also referred to the extent to which businesses in the engineering sector were restructuring contracts on an annual hours basis. This was reducing gross labour costs even ahead of productivity gains. Hourly wage rates might rise under such arrangements but there was often a dramatic change in shift patterns which enabled large savings, in addition to the benefits of higher productivity.

Sir Ian said the automotive sector still faced the problem of overcapacity. German domestic demand had not recovered to the degree expected and sales remained lower than a year earlier. This was affecting the whole sector. The upturn in demand in France and Spain seemed to have moderated and it was unclear what was ahead. There was a degree of nervousness about trading in September. He also said that on the basis of current production plans, imports were likely to account for more than eighty per cent of the UK automotive market in the next few years. The proportion had been sixty per cent for some time but had recently risen to between seventy and seventy five per cent. This would inevitably effect the trade data in due course.

Mr King emphasised that the MPC was very interested in the issue of contracts. It was puzzling that the number of hours worked per employee had declined. This was very odd in the context of an expanding economy. Sir Ian said there had been an increase in the use of short-term contracts to deal with seasonal peaks in output and, consequently, less overtime working. In addition, the move from standard to flexible hours resulted in lower average shift premium rates. Previously, night shift premiums were around one-third of normal day shift wage rates. A move to a three day shift pattern enabled as many production hours but lower premiums and fewer overtime hours. More people were employed because of the extra shift but on fewer hours. He said this had been accepted by unions but involved some painful adjustments insofar as this would reduce the wages of many employees. Mr King said this was consistent with more jobs and lower average hours, and benign wage cost inflation.

Mr Buxton commented that much of the growth in employment was in the service sector whereas employment in manufacturing and agriculture had fallen, another aspect of the skewed economy. The picture in the banking sector suggested a confident consumer. Retail business was very strong. Mortgage lending was growing at around 9% a year and consumer credit by 14% on the basis of data for June. Mortgage lending was expected to moderate but from very high levels. He also noted that small and medium sized firms were starting to increase borrowing. Mr King noted that consumer borrowing was at a seven-year high though leading indicators of housing market activity – such as site visits – were suggesting a slowdown ahead. He reiterated that one of the risks in the *Inflation Report* forecast was for less of a slowdown in consumer spending than envisaged in the central projection. The Agents' Reports suggested that the high level of corporate borrowing was related to investment rather than distress borrowing.

Mrs Heaton asked whether the reduction in the average hours worked could be accounted for by an increase in black economy activity? Mr Neill said the changes in hours worked had started in just a small number of companies but had now spread to many other sectors of business, driven by the need for productivity improvements. He said it had been relatively easier to introduce such changes in sectors like telecommunications because they were staffed by a younger workforce with different expectations. Sir Ian Gibson added that productivity gains were also being achieved by better management of external businesses. He said some businesses were reducing expenditure on services by 25%.

Sir Brian Moffat said the immediate trading outlook would partly depend on what assessment people made about their own order books when they returned from summer breaks. He said there were reasons to be negative, given the situation over the summer in many European markets.

Mr King thanked Members of Court for their contributions. He said they had shed light on some important issues and he would relay the points to the MPC.

FINANCIAL STABILITY ISSUES

Domestic and international developments
(Mr Tucker in attendance)

Mr Tucker reported on two domestic issues and two international issues relevant to the work of the financial stability area of the Bank. On the domestic side, the Government's response to the Cruickshank Review of banking services had been published. This had contained two matters of particular interest to the Bank. First, in relation to the issue of 'lender of last resort' (LOLR), he reminded Court that the Cruickshank Review had recommended that the use of LOLR facilities should be made public within one year. The Government had accepted the Bank's view that the timing of disclosure should depend on whether disclosure could threaten stability. Late in the day, HMT had raised the question of who should decide when to publish details of LOLR involvements, suggesting that it should be the standing committee of the FSA, HMT and the Bank of England. They had, though, agreed to delete this on the basis of the Bank's argument that, while HMT would of course be consulted, the decision was for Court.

The second area of interest in the Cruickshank Review concerned the regulation of payment systems. Mr Tucker said the Government's response had, on balance, been encouraging. It had met the Bank's concerns that regulation should focus on retail rather than wholesale systems and that account needed to be taken of the international dimension regarding the location of payment systems. The Bank had emphasised in its discussion with HMT that the offshore threat was real if legislation became onerous. Mr Tucker said the choice of regulator was between the OFT and a new regulator (PAYCOM). The Government had so far not indicated a preference. Additionally, the Cruickshank Review had called for the FSA to publish capital ratio regulatory targets. HMT and the FSA would study this issue further, and the Chancellor had indicated that the Bank's views would be welcome.

The other domestic issue to draw to Court's attention was the work being undertaken on financial exclusion, in particular access to business finance. Mr Tucker reminded Court that the Government had asked the Bank to study this issue as part of its wider consideration of social exclusion. Field work was now under way in different parts of the country. To date, the Bank team had been struck, though not surprised, by the limited extent to which small businesses considered raising finance to be a key issue in such areas, compared with other social problems.

Turning to international issues, Mr Tucker said the debate on the appropriate international financial architecture to prevent and resolve financial crises continued. A lot more progress had been made on prevention than resolution. The US position remained a preference for a case by case approach. The Bank and others were stressing the need for clarity over the division between official and private sector involvement. The Bank had undertaken some work with the Bank of Canada on the issue, and a paper had been circulated around the international community. It supported the need for a clearer framework outlining approaches and responsibilities in the absence of an international lender of last resort. The paper stressed that countries were bound to call debt standstills and moratoria, so there was a need for an operating framework which recognised that this would happen from time to time. There needed to be some clarity about the limits to IMF support.

Mr Tucker said the debate was now open and a paper by Alan Greenspan and Lawrence Summers would ensure that it was on the discussion agenda. A recent G10 meeting of Central Bank deputies in the Bank had suggested some support for the Bank of England/Bank of Canada approach, with the exception of the United States. The next G7 Finance Ministers deputies meeting, ahead of the IMF Prague meetings, would be important.

The second international issue of note concerned work towards the new Basel minimum capital requirements for banks. The framework had more or less been established but the important work was to follow, when the numerical aspects of the proposals could be established. The key issue was whether the new requirements would affect the amount of capital in the banking system.

In response, Mr Buxton said that he hoped the Bank would play a constructive part in the discussions on payment systems. He said he was worried that HMT had little experience in this area. He added that a great deal was being said in the name of financial exclusion. Raising finance had always been well down the list of priorities of small businesses. He felt the sooner the Bank gained some prominence in the discussion, the better. Its work to date on small business had been extremely beneficial in raising issues.

Baroness Noakes asked if PAYCOM was likely to be at the Bank. Mr Tucker said this would not be the case. The Bank had not wanted a competition policy role. It would either be at the OFT or a new regulatory body. HMT had recognised that the Bank has a close interest in the oversight of payment systems.

MANAGEMENT OF THE BANK

Operation of NedCo
(No visitors in attendance)

Baroness Noakes asked Court to approve the operation of NedCo, as outlined in her paper, in order for it to discharge its functions under the Bank of England Act 1998. Court approved the operation of NedCo.

Court APPROVED NedCo's method of operation as proposed.

Audit Committee Report
(No visitors in attendance)

Mr Buxton drew Court's attention to the draft minutes of the Audit Committee held in July. He highlighted two points. First, the Committee had so far considered the management of the Bank's balance sheet, and credit risk and reward. He said a risk matrix had been in place for some time but that it was too detailed to be an effective tool for senior management. The key issues were clouded by its complexity. The matrix was now simpler and more comprehensible. He said the Committee's discussions with different parts of the Bank had revealed concerns about operational risks. To date, this was not something the Committee had focussed on. He had asked the management of the Bank to report separately on operational risks.

Second, Mr Buxton commented on the Audit report by PricewaterhouseCoopers. Credit risk was not perceived as widespread but moreso at particular times. The issue of operational risk was also raised by the Auditors, along with some proposals for improving this aspect of the Bank's management. Mr Buxton also mentioned that he had requested more information about financial reporting by the Printing Works as the Committee had not been satisfied with the situation that had been described to them.

Sir Brian Moffat raised the question of whether the Audit Committee should only consider financial risks. If Court itself was to consider non-financial risks, he noted that the Turnbull guidelines required it to do this more than once a year. Mr Buxton said Court could use the Audit Committee as a channel through which non-financial risks were considered.
Baroness Noakes said this was unclear, specifically whether Court would discuss this issue as a body or have the Audit Committee report to it. Sir Neville Simms commented that Court needed a process which engaged it substantially with the risks faced by the Bank. This could not be achieved by a short report from the Audit Committee. Sir Brian Moffat agreed that an executive procedure was required. Baroness Noakes said she would request a paper to Court on how the Turnbull guidelines would be discharged. Mr Buxton added that future Court agendas might include items on specific risk issues.

Mr King said the Governors were grateful for the contribution of the Audit Committee in bringing issues into open discussion. He said he saw this as part of greater transparency more generally in the way the Bank conducted its operations – for example, in relation to foreign exchange reserves. There certainly needed to be a proper executive view of risks that went beyond the work of one division of the Bank.

Baroness Noakes stressed that Court would require a paper from the Bank on how Court should handle its responsibilities and the procedures it should adopt. Mr Buxton added that the role of the Audit Committee should be to undertake digging exercises. Baroness Noakes said she would raise the issues with Mr Clementi.

Sealing Committee Authorisations for inspection
(No visitors in attendance)

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

Court was up.

Noakes

20th September 2000

Peter Rodgers

20 September 2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 SEPTEMBER 2000

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Ms Blow
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Sir Brian Moffat
Mr Neill
Ms Kathleen O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Mr Bailie
Mr Buxton
Ms McKechnie
Mr Morris

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

MANAGEMENT OF THE BANK

Compliance with the Turnbull Report
(Executive Directors and Messrs Butler and Ingram in attendance)

In relation to the maintenance of sound systems and controls within the Bank, Mr Clementi updated Court on the work carried out since February when Mr Butler had reported to Court on the implications for the Bank of the guidance on internal control issued by Turnbull to directors of listed companies. In a PowerPoint presentation in the Conference Centre, Mr Butler took Court through the developments in the risk matrix and Mr Ingram took Court through a presentation on monitoring risk in the Bank of England's balance sheet. In response to a question from Sir Chips Keswick about whether the Bank still had a rating capacity for sovereign debt or whether it still relied on credit rating agencies, Mr Ingram said that CRAC looked at the agency ratings of individual countries but coupled these with the Bank's own analysis. The Bank did not rely mechanistically on agencies but they were a very important part of the judgement made.

In response to a question from Ms Blow, Mr Butler said that the Bank could certainly comment in qualitative terms in the Annual Report on the changes made. It could note that there had been many changes to risk management procedures in the last five years and not just in the last 12-18 months. The Report could also note that, in relation to the Assets and Liabilities Committee, meetings were quarterly, and this added real value in helping departments understand the nature of the financial risks the Bank was running. He also noted the annual risk assessment exercise which was more dynamic and involved management (specifically MANCO) more than it did before through the rating of risks. The Governor said the Bank would look into the question as it came to the Annual Report process.

Ms O'Donovan noted that some companies had set up Risk Committees in addition to Audit Committees. Mr Clementi said that from the financial management point of view the Bank could pick up risks from two main committees, ManCo and ALCO. In the latter there was quite a vigorous quarterly debate, with himself and Mr Plenderleith, Deputy Directors and HODs present. Between these two committees the Bank could handle the issue and he saw no reason to set up a third. Mrs Heaton said she was encouraged by that. She noted the importance in management of the need for day to day and quarter to quarter discussions of risks. She noted that the last paragraph said that not all risks were captured. Mr Clementi asked whether she was referring to lender of last resort and foreign exchange intervention. Mrs Heaton said she was referring to strategic issues, for example, such as a risk that the MPC process led to too much or too little inflation - in other words to the key activities of the Bank. Mr Plenderleith said that risks under those headings would be captured in the assessment of financial risks. The Governor believed Mrs Heaton was referring not to financial risks that arose out of the pursuit of the Bank's core purposes but to reputational risks. Mrs Heaton said she was referring to risks that hit out of the blue, for example a financial crisis. The risk analysis covered day to day risks but not the biggest ones. Mr Butler said that the risk analysis process started at the top with strategic and reputational risks that included the kind Mrs Heaton had identified. Mrs Heaton asked whether it was possible to analyse the size of the financial impact of such risks and their probability and also to draw up a ranking. Baroness Noakes said that Court ought to be able to say what were the top end risks of importance to the Bank. Mr Clementi said it would be possible to produce a list of all the high impact risks. Baroness Noakes said that that was all that Court should look at and Mrs Heaton agreed. Mr Plenderleith commented that there were five areas of higher risk in Mr Ingram's presentation and they could easily be pulled out and identified separately. Sir Neville Simms said that as an Audit Committee member he would be very pleased if Court could look at those higher level risks.

Baroness Noakes noted that when the Bank started on the risk matrix there was a reluctance among individuals to sign off. She asked whether it was clear that all the risks identified had risk owners who had accepted full responsibility for them. Mr Clementi said that the Bank's intention was to have a sign off up to Executive Director level for the areas for which they were responsible. Mr Neill said it was a very good presentation and he was encouraged to see the level of the Bank's IT literacy. In response to a question from Mr Neill about human resources in the risk matrix Mr Clementi said that the biggest risk in that area, in his view, was the ability to recruit and retain good people. Mr Butler took Court through the details of the risk matrix in that area. Sir Ian Gibson echoed Mr Neill's comments and said he believed that a version of the risk matrix should be made available on the Intranet in a simplified format. One of the issues was devolving the process and increasing awareness. He hoped that would happen and that Court would be told.

The meeting moved to the First Floor Committee Room. The Governor welcomed external members of the MPC, whose full membership was now attending the Court meeting.

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC Report to Court and including international economic developments
(All Executive Directors and external MPC members together with Messrs Jenkinson and A Bailey in attendance)

In introducing the Minutes of the meeting of the MPC held in the first week of September, which had been published earlier that morning, Mr Vickers said that the MPC had held rates at

6% and the vote had been the same as in August. He noted that, in the international economy, oil was around $30 a barrel at the last Court and it was now between $33 and $34. The exchange rate index had fallen to around 106, driven by a large fall against the dollar. In the domestic economy, GDP growth was 0.9% in the second quarter and the number had not been revised, which was not a great surprise. Consumption growth was firm while Government consumption was quite strong, though investment was rather weak. More would be learned from the National Accounts on 27 September. Mr Vickers noted that industrial production fell slightly month on month in July but energy output had not, as expected, fallen strongly. Surveys of activity showed a picture broadly the same as before while retail sales volume rose 0.6% on a month earlier in August but sales growth had slowed according to the distributive trades survey, partially offset by a big improvement in motor trades, though that area was still very negative. He noted a rise in the GfK consumer confidence index in August but falls in the Halifax and Nationwide annual rates of house price inflation. Money and credit were still quite strong and there was a particular puzzle of strong corporate borrowing, though business investment had softened somewhat. In the labour market, quantities were strong but earnings were weaker than expected with headline earnings growth easing further to 3.9% in July. The slowdown in pay growth had mainly been driven by bonus contributions. He noted a rise in employment by 93,000 in the three months to July. Labour force survey unemployment was down 104,000 to 5.3% in July. Claimant unemployment was down 18,000 in August and the rate was down to 3.6%, the lowest since September 1975.

Turning to prices, he said that RPIX inflation fell by 0.3 percentage points to 1.9% in August, the lowest since the series began in 1975. This reflected a lower contribution from petrol and seasonal food prices. He noted that in general there could be quite a lot of volatility because of oil and other factors. RPI and RPIY fell broadly in line with RPIX. Turning to the petrol shock, he said it was clearly going to be difficult to assess the upcoming data as a result. There could be all sorts of things happening on the corporate side including an impact on stocks, while the effects on consumer expenditure were unclear. It was very hard to judge in many cases the direction let alone the magnitude of the effects of the fuel shock. The Bank would try to judge that through Agents' surveys and through other surveys as well.

Turning to international economic developments, Mr Bailey said that the overall picture in the world economy was that growth this year was likely to be the strongest for more than a decade and the pattern among regions more balanced than for quite a long time. Over the spring, at least, there was more robust expansion in the euro area, though the latest data suggested that there may have been a peak in growth rates, though that was what the Bank had expected. The same pattern applied to the emerging market recoveries. There were now encouraging signs of a more sustained but more gentle recovery in Japan. Having said that, there remained substantial imbalances in the world. The most obvious was the current account positions, particularly in the US, where the external deficit was still rising, and alongside that were exchange rate issues, particularly the weakness of the euro and the increase of the dollar across the board. Most analysts reckoned that the prospect of a soft landing had if anything increased and that had led markets to a more optimistic outlook. There had been a succession of gradual monetary policy tightenings across the board. Japan had until recently been the notable exception to this, but the Bank of Japan had now ended the zero interest rate policy with a very small increase of 0.25%, which was perhaps more to do with market distortions than supply and demand in the economy. So far there had not been an adverse reaction. The ECB faced a difficult environment. Growth had been strong in the euro area and there were suggestions that demand was outstripping supply capacity quite rapidly, and the big issue underlying this was structural. The ECB was also faced with the exchange rate issue and with the oil price. The ECB had had a policy of gradual rises reflecting inflation prospects going forward and this made a good deal of sense. Mr Bailey noted problems of overheating in some smaller economies, particularly in the context of Ireland.

Turning to oil, he noted the price was very nearly at $35 a barrel. Over the short term this would have a direct effect on retail prices. The possible second round effects would be very important but so far, encouragingly, there had been very little sign of an effect on wage demands across the board. The context was very different from the 1970s. There was no background of rising inflationary expectations and the energy intensity of the major economies had declined very significantly over the last 20 years. Much of that decline was in the industrial sector. The share of transport in oil consumption had risen very sharply from around 45% to around 70%, a rise which was perhaps not unrelated to the pattern of protests. Forecasting the oil price was hazardous. OPEC had promised a further increase in production, bringing the total increase to three million barrels a day. World demand had most likely not gone up by more than that, but stocks were very low going into the winter, which was a factor worrying the market. There was also a downward sloping futures curve, leading to a reluctance to hold stocks. In addition there might be a "just in time" effect. OPEC had an immediate quite limited additional supply capacity, of which Saudi Arabia had the lion's share. Against that there was the prospective increase in supply that would be expected to come through over the next year or so as higher prices encouraged more investment in exploration and extraction. OPEC had said that it wanted to target a price of $22 - $28 dollars a barrel. But OPEC had had no success over the years in managing the oil price actively and this was the first time that a major price rise had come more directly from the actions of OPEC and not from wars and revolutions. It was also seeking to manage the price in a range that it had never been kept in before. The oil market saw prices of just under $20 a barrel as justifiable over the longer-run, related to the cost of bringing in new capacity. So prices could remain high for the next six months or so but there were good reasons to believe that this would not be a prolonged feature of the oil market.

Mr Plenderleith, turning to charts one and two on foreign exchange, said that the dominant story was the renewed strength of the dollar in the last month or so, explicable by the greater confidence in the markets that there would be a soft landing in the US. The counterpart had been partly a weakening of the euro, which could not be explained just in terms of the dollar, because it had fallen against the yen and most other currencies. There were a range of explanations but the nearest one could get to a single coherent framework was that it reflected a market perception that the euro-area's trend growth potential was lower than that of the US economy. Sterling had been weakening against the dollar. It had come down in the spring from the $1.60 that it held for two years or more to $1.50, where it stayed in the summer, but more recently it had dipped to $1.40. That might be the counterpart of the stronger dollar. There might be some comfort from the fall, but the effective rate had remained relatively high. The fact that sterling had come down against the dollar and was moving more closely with the euro needed to be watched closely, and he was not sure it was fully understood. Turning to interest rates, in chart 3, he said there was a continuing fall in the strength of expectations of further rises in the UK. The markets saw rates as close to the peak of the cycle. Turning to chart 5, bond yields, he said that there was some indication of a small rise in bond yields in most of the markets in recent weeks, notably in the US. This might be a consequence of the fact that both presidential candidates were being seen as less committed to surpluses than the present administration. It might also reflect greater apprehension about higher inflation in the world economy, because of oil prices and perhaps faster growth. On the other hand, it might be a summer blip. This also needed watching.

The Governor asked the external members of the MPC if they wished to add anything. Dr Wadhwani said he would like to ask members of Court about the extent to which they believed higher oil prices would feed through into higher prices generally.

Sir Chips Keswick said it would be a great mistake to patronise OPEC because it had made clear that it wanted $35 a barrel last February and this had not been taken seriously. Now they had achieved that level. He would not be confident about prices returning to $28 a barrel. Mr Neill noted that in the automobile and other industries there had been a move to lean production systems. For example, if the manufacture of one component, fuel tanks, for which there were four deliveries a day, were stopped, then a car manufacturer could not make a car. Stopping the industry for a day wiped out a year's profit. In that sense the industry would pay whatever it needed to keep production going. Companies could consider whether the risks taken with such systems were too great or they could decide that they could not, for competitive reasons, afford to drop them. So they were coming to the conclusion that they needed to make sure that the Government ensured that events such as the fuel crisis did not happen again. Ms O'Donovan said she was surprised at the rather rosy view of the United States. Her company had issued a high profile profit warning ten days previously and there had been similar warnings for other equally high profile companies. They covered capital goods and the appliance markets, which were being affected in the US. There was a margin squeeze both in the US and in the UK. Sir Brian Moffat, speaking as a heavy energy user, said that there would be a delayed impact from the oil price situation because high prices would come through when contracts ran out and were renewed. For shorter term contracts for gas, particularly interruptible supplies, prices had risen 40% since January, and the increases on the continent were not very different. People had tried to pass these on and had had a degree of success but nothing like the full 40%. There was going to be a cascade effect as far as the consumers of basic materials were concerned. The pressure would be to absorb price rises or find substitutes, perhaps even going back to coal, though not in a traditional way.

Sir Neville Simms said the picture was very similar in construction. Output and new orders were still growing year on year implying that the construction peak was at least two years away. The result was that there was great stress on employment issues. The pressure would not be on wage settlements, which were national, but on other aspects of remuneration. Employment seasonally adjusted was as high as in 1992 while input prices were rising for the twentieth month in a row. There was nowhere the construction industry could put price increases except to the client, and the industry was as efficient as it reasonably could be. Fuel was an important input. In response to a question from the Governor, Sir Neville said that demand in the housing market was relatively flat, but while commercial building had dropped a little it was still very strong. If promised Government programmes were delivered it would add to the work the industry had. The industry was not good at increasing efficiency in these circumstances. Ms Blow said that companies in her sector were being cautious in decision making and she expected that to become worse going forward. On fuel prices, she was in an industry that should be able to avoid travelling and so this was a small element of costs.

Sir Ian Gibson said that, overall, Japan seemed to be more confident than he had seen in the last two years, though he did not understand how the yen could remain at current levels. In Western Europe demand for commercial vehicles showed a continued decline and the industry was looking to a flat year next year. Global component suppliers were beginning to send out profit warnings, including businesses with large sales in the US. Margins were clearly under significant pressure. At the same time, within Europe there was increasing reluctance by consumers to pay. Nobody in the industry knew how these pressures would be resolved. He said that Mr Bailey's analysis of the oil industry was the one accepted by his industry.

Sir Brian Moffat said that during the first six months of 2000 steel demand in the European Union was up 2% while production was up 10%. This indicated that there was a stock pile somewhere. Imports to the European Union had been increasing for some time. In reply to Ms O'Donovan, Mr Bailey said that in the US there was a very sharp bifurcation between hi-tech industries and the rest, and the story she told would be consistent with that. There was tremendous support for growth coming from a relatively small part of the US manufacturing base.

Agents' Report on 'Issue of the Month'
(Executive Directors, external MPC members, Ms Camper and Mr Jenkinson in attendance)

Ms Camper introduced the findings of a survey of the Agents' business contacts' use of e-commerce. The survey had been undertaken in May and presented to the Pre-MPC on 1 June.

After explaining the findings and conclusions of the survey Ms Camper added a postscript to cover events since May. She said the Agents' continued to question their contacts. There was no significant new development, but further progress had been made along the lines she had reported. There was increasing realism about the issues and awareness of the costs and also in particular of the early mover advantage. Businesses faced many challenges including the integration of external and internal systems, and they needed to keep their sites up to date. It was still difficult for the Agents to assess the impact on costs, prices and margins. There was continuing growth in the hi tech area and investment in IT and websystems. There would continue to be a demand for specialists. The infrastructure was always an important factor and the availability of band width was a particular issue. She noted the potential importance of m-commerce, with access through WAP phones, the third generation mobiles.

Sir David Cooksey commented that there could be a problem with the survey in that the normal group of Bank contacts might not reflect the enormous number of new entrants in this area. There was also the issue of what was happening to consumer behaviour, because the Internet was being used as a pricing tool from which to bargain and then carry out transactions in the normal way. Retailers were finding it impossible to raise prices because of this effect.
Mr Neill said it was a very helpful report. He agreed with Sir David Cooksey about the representative nature of the survey. He was concerned that the survey showed that Britain may not be moving at the speed at which it should be and some way was needed of measuring where we were in relation to the United States. He also commented that the Agents' report did not show other more wide-ranging uses of the internet, for example in the areas of information and knowledge management. Ms Camper said the Agents were always trying to refresh their contact base so if there were new types of firms they could be taken on board. Several of the firms spoken to were in fact new ones. The Agents tried to keep up to date but the point was absolutely fair. Sir Howard Davies said that on the financial services side it would probably look a bit better than the survey picture for the aggregate but in relation to international comparisons the UK would not look particularly progressive. Our financial institutions were by no means as advanced as those in continental Europe. The opportunity for margin erosion among UK banks was greater than in the rest of Europe. He would expect a very rapid expansion of internet banking and sales of financial services.

Miss O'Donovan noted that the report was the result of contacts with users and she suggested there could be benefits as well in sitting down with those at the forefront of developing the technology. Referring to the survey as a whole, the Governor asked Court Members to suggest contacts in the area to help the Bank make sure it was keeping up with the changes.

Ms Blow, picking up on Sir Howard Davies' point, said that her business was involved in these areas. She agreed there was a hesitation and was not surprised at a slow pick-up: she did not see greater investment until next year. Sir Chips Keswick noted that the contrarian end of Wall Street was beginning to cast some doubt on measures of US trend productivity growth. Baroness Noakes noted that the UK was 18-24 months behind the US and it was not necessarily the best option to ask UK people about the trends. She asked whether information could be obtained from the United States about the analysis there of the structural impact of e-commerce.

FINANCIAL STABILITY ISSUES

Review of the Financial Stability Area including domestic and international developments (Executive Directors and Mr Tucker in attendance)

Mr Clark noted that he had circulated a short paper picking out a number of issues on which the FS Area was currently working. The first was a possible public statement of the Bank's role in payment systems oversight. There was a question about what it should say but also about when it should be published. The Bank had to be sensitive to the fact that the Cruickshank Report had had a number of things to say on payments issues and the Bank did not wish to appear pre-emptive or, on the other hand, too obviously reactive.

Turning to financial architecture, he noted that the debate covered a lot of territory. The Bank had focussed on crisis management, particularly where there was a threat to the functioning of the financial system. He noted that a more structured approach would be preferable in the resolution of debt problems. He also noted that the availability of finance was limited and there might need to be some sort of standstill for private debts while problems were worked out. He drew Court's attention to the fact that the Bank had written a joint paper with the Bank of Canada and said the debate would continue in Prague, although he did not expect a definitive resolution there. Mr Clark also described the Bank's work on small firms in deprived communities, on the financing of small high-tech businesses and on capital standards for the Basel Committee.

Turning to the London Stock Exchange, he said the Bank had followed the debate but had not intervened, though recently some people had encouraged the Bank to do so. It was genuinely difficult to see the way forward. The Bank would keep closely in touch with the debate.

Mr Tucker noted that there had been two secondments to the Financial Services Authority, one to the small banks team and one to the large banks team, and secondments were also being explored with one or two other organisations. Turning to training, he said courses had been set up once or twice a year on the economics of banking, practical banking and finance theory. On information technology, the Financial Stability area had a pressing need to develop a common database which it did not possess, reflecting the changes in nature of the business over the past few years. The issue was now being explored with MA, and MSD, in the context of the new IFD coalition.

The Governor said that he thought the work of the Financial Stability area in general, especially in the international field, had made a tremendous impact on the international discussion. That was generally recognised and everybody told him that and he was very pleased.

Sir Howard Davies said that the Bank and the FSA were very much at one on the Capital Accord and he believed there would be a tricky debate over the next few months.

FINANCIAL MARKET OPERATIONS
(Executive Directors in attendance)

Mr Plenderleith commented on the gold auction programme, which was halfway through with eight auctions now completed. The Bank had been apprehensive about the latest auction because the gold market had been very subdued. In fact there had been a perfectly reasonable result at the auction on the previous day, which achieved a price of just over $270. This had been something of a relief because the July auction had also been disappointing. Nevertheless, there were structural changes occurring in the gold market and it would make the process less easy to manage. An eye was being kept on this and there might be a need to make changes, but not yet.

Turning to the Minimum Funding Requirement, Mr Plenderleith noted its importance: because the policy might have induced a shorter term outlook among investment managers, it might have distorted gilts yields downwards and it might be having an impact on future living standards of quite large numbers of people by locking them into low annuity rates, as well as generating a false sense of security among members of pension funds about the safety of their funds. Sadly, the debate had become mired in actuarial calculations. The report of the actuaries did not help. It offered various ideas for consultation and it suggested the Government should look more widely at safeguards. The Government had put the report and its commentary out for consultation and asked Paul Myners to address it in his review by November. The market was disappointed. Gilt yields rose when it was known the review was going to appear and fell when it appeared and resolved nothing. There would be consultation, which was healthy, but there was discomfort at the considerable time taken to bring it to a practical conclusion.

EXECUTIVE REPORT
(Executive Directors and Mr Footman in attendance)

Mr Clementi said the Bank was close to agreement with the Lawn Tennis Association about the establishment of a national tennis centre at Roehampton on a long lease, which would bring £500,000 a year of revenue. It was hoped negotiations, which would resume the following week, would bridge the gap between the two sides. Mr Clementi drew particular attention to the request from the LTA that, if Roehampton were sold in future, they would have a right to first refusal. In principle the Bank was willing to do this but the draft contract would have to recognise that this only applied if they paid the market value.

Mr Clementi said that he wished to update Court on the departure of the six staff who had not signed for BenefitSelect. First, though, he noted that a recent Unifi notice had implied that management had not told Court what was going on - or distorted the truth. He hoped that this had not been the case. He had been back over the Court minutes for the many occasions this issue had been in front of Directors, and believed that Court had been fully aware of the key points of principle the Bank were following. Certainly the key issues which stood between management and the Union had been discussed openly in Court – and Court had backed the stance taken, in particular the decision to introduce the new scheme for all members of staff with appropriate compensation, rather than grandfather existing arrangements.

Notices for the six who had not signed the new contracts terminated on 15 September. The Union had mounted a small scale protest on that Friday; and had delivered a petition. The Bank was likely to face claims in an Employment Tribunal. Mr Clementi believed the Bank had a strong case.

Separately, Mr Clementi noted that 34 staff had lodged appeals to be heard by the Tribunal claiming unfair dismissal. All had signed for the new package and still worked for the Bank. Again Mr Clementi believed the Bank had a strong case.

The Union had organised a petition. It called for the reinstatement of the six staff, and an inquiry into the handling of the new benefit package. It had been signed by over 700 people, one third of the Head Office staff. This was a significant number and, whether the grievance was justified or not, a sense of grievance was clearly felt. Some were unhappy about the changes, others about the way the changes were implemented, others about the general trend of change within the Bank.

GovCo had discussed the petition, and felt that an inquiry would serve no purpose. However they did propose two particular actions:

> Review of leave arrangements. Many of the complaints related to the new holiday arrangements. The Bank committed some time ago to a review after six months, from 1 October, and would discuss the results with the Union.
>
> As discussed at the recent dinner at New Change, the Bank intended to carry out a staff survey, using panels to determine what the issues were in each part of the Bank which were of concern to staff. Mr Footman had interviewed four firms two of them suggested by members of Court, and GovCo had chosen to work with ISR who carried

out the survey back in 1995. Mr Clementi hoped to complete this work as soon as possible and then to come back to Court.

Mr Neill commented that he had read the material put out by the Union claiming that the Court had not been properly informed. He stated that this was not the case. He felt perfectly adequately informed and as a result supported the Bank's plans and the decisions the Bank had made. He would be very happy indeed for Mr Clementi to tell the Union that. Mrs Heaton agreed.

The Governor drew Members' attention to a dinner to be held at the Cutlers' Hall in Sheffield on Tuesday 16 January - the day before the Court meeting in Leeds. The dinner would be jointly hosted by Yorkshire Forward, an organisation promoting business investment in Yorkshire, and the Bank and the Governor extended an invitation to all those who were available to attend. He said Court would be briefed more fully on the Yorkshire events in October.

The Governor also noted that on 29 September he, with the Lord Mayor and Sir Howard Davies as Chairman of the Financial Services Authority, would hold a reception in the Bank to introduce to a wide audience from the City an idea they had developed, prompted by an earlier idea from the City itself, to try to raise the profile of the City's community and charity involvement. There were three legs: first to encourage those already engaged in such activities; second to encourage those who were not engaged to become so; and third to raise the public profile in the broadest sense. He had asked Mr Buxton to chair. It would culminate in a day's events in the context of the City Festival next July. The slogan was "Heart of the City". The reception would be seeking the support of the City. There had been quite wide consultation and he had found considerable enthusiasm. Members of Court had been invited, and were welcome to attend.

[redacted]

69

[redacted]

The Governor asked for the minutes to record his deep gratitude to John Vickers for all that he had contributed as an Executive Director of the Bank and also as a member of the Monetary Policy Committee. He hoped to have other occasions at which he could say this more publicly. He was very sorry that Mr Vickers felt he had to respond to the call of other duties, but he understood that and wished him every success.

Court was up.

18 October 2000

18 October 2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 OCTOBER 2000

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Ms McKechnie
Mr Morris
Mr Neill
Ms Kathleen O'Donovan
Sir Neville Simms

Absent:

Mr King, Deputy Governor - Monetary Policy
Ms Blow
Mrs Heaton
Sir Chips Keswick
Sir Brian Moffat
Mr Stretton

The Governor welcomed Charles Bean to his first meeting as an Executive Director of the Bank and member of the MPC.

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, including the monthly MPC Report to Court (Executive Directors, Professor Nickell and Dr Wadhwani in attendance)

Mr Bean noted that rates were unchanged in October and the vote was unanimous although this concealed divergences of views on the Committee in their assessments of the balance of risks going forward. He suggested that some of the press comment was likely to misinterpret unanimity. He also noted that the FOMC kept rates at 6.5% in October but the ECB raised rates by 25 basis points to 4.75%. Turning to the international economy, he said one question was whether the US was in line for a soft landing. Another question was whether there were signs of the euro area slowing sooner than expected because there was evidence that the recovery might be petering out. Price pressures remained, and the HICP for the EU 11 members rose to 2.8% in August, which was above the ECB limits on what constituted price stability. He noted that Japan continued to improve. The oil price was still high and was likely to fall back to $25 or less in the medium term, although the adjustment might be erratic. The general view inside and outside the Bank was that this might knock 0.5 percentage points off world activity. Higher oil prices were bad for inflation but would be offset by a strengthening of the pound. Mr Bean also noted that the ERI was around 106 at the time of the last Court but was now 108.7, driven by an appreciation against the euro and the dollar.

Turning to domestic demand and activity, he said the second quarter GDP remained at 0.9% growth and a preliminary estimate for the third quarter would be available at the end of the week. Overall, it was likely to come in weaker than Q2. Retail sales grew 0.6% in August but indicators for cars, confidence and housing pointed to the fact that consumer demand was likely to be weakening. M4 lending was strong but most of that was associated with high levels of corporate borrowing related to M & A activity and third generation telephone licenses, not high spending. Industrial production rose 0.6% on a month before in August while manufacturing was up 0.8% on a month before virtually all of which was due to electrical and optical equipment, mostly mobile telephones. The British Chambers of Commerce survey showed that manufacturing continued to recover somewhat in the third quarter but there was a generally weakening picture for services, the latter being confirmed by the CIPS services survey which showed activity slightly weaker in September. The two speed economy was tending to disappear to a degree. The general picture was that overall domestic demand and activity seemed to be slowing gently. The effects of the fuel crisis were probably quite small although they would cloud the interpretation of indicators for the next month or two. The Bank's assessment of the disruption to fuel supplies in September was that it would be largely transitory, but would make it difficult to interpret statistics for a month or two.

Turning to the labour market Mr Bean noted that this was one of the areas where there were puzzles and differences of view. Headline earnings growth rose 0.1 percentage point in August to 3.9%, with manufacturing still growing faster than services. Earnings grew by 4.1% in the 12 months to August while the claimant count fell by 16,400 in September and the rate stayed at 3.6%. Labour force survey measured unemployment fell by 100,000 in the June to August period compared with the previous three months. The unemployment rate was now down to 5.3% from 5.6% in March to May. Employment rose by 80,000 over the same period. Survey indicators also suggested labour market tightening. One puzzle was why, despite a relatively tight labour market, earnings growth had remained so muted.

Turning to prices, Mr Bean said that annual RPIX rose to 2.2% in September from 1.9% in August; most of that increase reflecting higher contributions from petrol. Input prices rose by 14.3% in the year to September. At the moment inflation had continued to undershoot the 2.5% target, but there were worries about underlying wage pressures, and a question about the extent to which continued competitive pressures in the goods markets would help keep output price inflation down. There had been some upturn in inflation expectations of the public and trade unions, and one of the concerns was that that would start feeding into high wage settlements.

Mr Plenderleith said the picture on the exchanges was extremely confused with different influences pulling in different directions. The dollar remained relatively firm and the main driver was a sense that though the US was slowing a bit it was still growing quite fast by normal world standards and attracting inflows of capital. Offsetting that was a feeling that the end of this trend might possibly be in sight. He noted poor corporate earnings figures which had had a weakening impact on the equity markets, which might tend to dampen the dollar. Offsetting these effects had been a safe haven status for the dollar at a time of uncertainty in the Middle East, though the scale of the effect had not been as great as normally expected. It had led to a shift from equities into bonds. The picture was clearer for the euro. Concerted intervention had temporarily braked the decline but this had resumed with renewed determination. The ECB's recent interest rate rise was seen as intended to help the euro but it did not, which made views more gloomy. Explanations were multiplying. The US emphasised the fundamentals whereas euro area spokesmen said the currency was irrationally oversold. The Middle East crisis had not helped, because there was a tendency for money in Europe to move to safer havens in the UK and Switzerland. Sterling had gained against the euro but also somewhat against the dollar, having shown weakening signs earlier. At $1.455 it was above the trough last month of $1.40. The index at 109 was still substantially up on the range of 105 to 106 last month. Mr Plenderleith drew attention to chart 3, showing interest rate expectations in the UK had softened further, and to chart 6, of equity prices, showing a retreat in the main markets, particularly those such as NASDAQ which put a greater emphasis on high tech stocks.

Dr Wadhwani asked Court to comment on the likely output for wage settlements. Mr Morris said the general feedback from workplaces he had visited was that there was no evidence that the headline inflation figures were going to significantly influence wage bargainers. Settlements would to some extent be offset by increased productivity and there was clear evidence even in manufacturing that the productivity issue was being addressed more effectively than for some time. Unit costs would rise, as a percentage, less than headline rates. Mr Morris noted there was a still a shortage of certain skills, and this tendency would be increased with unemployment under a million.

Ms McKechnie said that the CA consumer confidence survey was showing contradictory signals. Consumers were expecting a marginal improvement in labour market activity and conditions in the labour market to be more favourable. But employment prospects were shifting the other way. There was no change in the level of savings people planned to hold in the coming months and there was a slight rise in precautionary savings from 60 - 62%. There was no change in consumer plans to make major purchases, but consumers were expecting to increase their future spending on non-essentials. On house prices, there was a slight shift upwards in expectations. Consumer confidence in the future value of investments had fallen but was still more than in 1999.

Mr Bailie said he agreed with Mr Morris on wage settlements. Pre-meetings were under way for the February wage round but he did not anticipate any huge increase. He did not see any head of steam building for above inflation increases. He noted closures of garages on the Northern Ireland border area because of petrol prices. He also noted high wages in Dublin, for example builders being offered £1,400 a week, but this was not putting great inflationary pressure on wages in Northern Ireland, which might be regarded as strange. Partly it may be a reluctance to travel. Mr Bailie noted the continuing political uncertainty in Northern Ireland.

He also noted that the British Tourist Authority was concerned about the effect of the Middle East crisis. He added that TV ads in the fourth quarter were reckoned to fall 8% which could be a deflationary sign.

Sir Neville Simms said construction continued to be strong and he indicated that this would continue into next year. On employment and wages there had been 18 months of increased employment in construction, though the last report of CIPS said this was beginning to flatten. His view of basic wages was that they would continue to rise and this would not be directly attributed to productivity gains. But the construction industry was getting to a self limiting point.

Mr Buxton said that services were doing quite well and were showing the same sort of pattern as over the last two years, with above inflation rises offset by reducing numbers. He believed there would be announcements about pay that would look expensive but would not be so when the numbers were examined. Turning to lending, he said figures on personal lending did not bear out suggestions of an aversion to borrowing because the figures were rising very fast. In contrast secured lending on mortgage was slow.

Mr Neill said he could not tell whether the current inflation rate was leading to higher wage settlements in the automotive industry but he could say that the losses coming through were very high and the industry had no ability to pay for increases. Sir Ian Gibson said he broadly agreed with Mr Neill. In the automobile industry as a whole labour costs would decline. The industry had entered a period where lots of plants were closing and that affected peoples' aspirations. There would be the odd higher settlement to buy peace, but the industry had to have lower unit costs. He noted that vehicle manufacturers were beginning to disclose bad figures. Ford and General Motors, at the European level, had said they were experiencing significant losses. He also noted a sharp decline in the German car market where the industry was re-writing assumptions about the market's natural size. There could be fundamental changes underway in the scale of the market for new cars, and that might force a re-evaluation of other European markets. With longer vehicle life and higher fuel costs, customers may be deciding to live with a longer replacement cycle.

Ms O'Donovan said that employers in electronics and engineering felt the same about wage pressures. Workforces were less confident and would go for security above higher settlements. She noted that to maintain margins there was a movement to low cost production countries. Sir David Cooksey said he wished to reinforce what was being said about the motor industry. There were great pricing pressures downwards because of the euro and in the mid-corporate sectors wage pressures would be very low. In IT there was a tailing off of demand so there was a pretty depressed picture right across the sector.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Executive Directors in attendance)

In updating Court on international financial stability matters, Mr Clark first mentioned the IMF and World Bank annual meetings in September. Although over-shadowed by the concerted G7 foreign exchange market intervention and the developments in the oil market, he felt that the meetings had made some progress on a crisis management framework for resolving debt problems. There had been helpful general comments in the G7 communiqué and indications that the private sector was favourable towards such a framework. The Bank would be developing, with the Bank of Canada, the proposals contained in their earlier joint paper.

Mr Clark next reported on a seminar chaired by the Governor which had focussed on the functioning of the financial sector in relation to entrepreneurs and small firms in areas of social exclusion. The clear message to emerge was the need for greater co-ordination both locally and nationally, for example to embrace the role of credit unions. The Bank would shortly be publishing a report which was expected to be the first of an annual series.

Turning to the Basel accord on capital standards, Mr Clark said that an important meeting would be held the following week. The crucial question was whether agreement between the Americans and Europeans could be achieved.

Mr Clark finally noted recent media comment about exposures to the telecommunications sector, which had seen a number of heavily-geared transactions. The prospects for the sector were less glowing and some institutions had substantial underwriting positions outstanding. The Bank was monitoring the situation and seeking information on exposures and losses. He agreed with Ms O'Donovan that some lenders may have been unwisely tempted by the high front end fees which had been on offer.

Mr Morris asked Mr Clark to comment on the feasibility of European harmonisation of petrol prices. Mr Clark responded that, since duty was such a large element of the price, the attitude to tax harmonisation would be a critical factor.

FINANCIAL MARKET OPERATIONS
(Executive Directors in attendance)

Mr Plenderleith reminded Members about the 'banknotes held to order' scheme under which banks were able to retain working stocks of banknotes for resorting and reissue or return to the Bank without having to pay for them. The scheme minimised the risks in transporting notes to and from the Bank. The Bank had noted that stocks of notes held under the scheme were growing more than was thought necessary, partly because of the banks' changed approach to note distribution via their own cash centres; the intention for those banks long on notes to supply those which were short was no longer working on a day-to-day basis in the way that was intended. The banks had recognised the need for a review and had responded positively to proposals for changes which the Bank had circulated. The next stage was to discuss questions of detail and timing, and Mr Plenderleith undertook to report the outcome to Court in due course.

Mr Buxton recalled that he had previously questioned the role of the Leeds Cash Centre in the note distribution arrangements. The Centre had an inconvenient City-centre location which made security more difficult. He suggested that the current review of the notes held to order arrangements was the time also to address the issue of the need for the Bank to have a Cash Centre in the north of England alongside the banks' own cash centres. Mr Plenderleith said that the point was taken. The intention was to dispose of the Leeds Agency building, of which the Cash Centre was a part, but with provision for the Cash Centre to remain in situ for the time being. Once the way forward on future note distribution arrangements was clearer, relocation to a more suitable site was a possibility, or indeed the Bank might need to review whether it needed its own Cash Centre in the north at all.

EXECUTIVE REPORT
(Executive Directors in attendance)

The Governor advised Court of the current proposals for events surrounding the meeting of Court in Leeds on 17 January 2001. It was intended to follow a similar pattern to that adopted in Edinburgh. On the evening of Tuesday 16, there would be a dinner for Yorkshire-based businessmen at the Cutlers' Hall in Sheffield, jointly hosted by Yorkshire Forward and the Bank, to which Members of Court would be invited. Overnight accommodation would be available in Leeds and, on the following morning, Court would be held at the Leeds Civic Hall. That would be followed by lunch in the Banqueting Room of the Civic Hall, to be hosted by the Bank; invitees would include civic leaders, local MPs and businessmen and representatives from regional financial services. Following the lunch, the Bank hope to arrange a number of separate events which Members of Court and MPC members might attend; details would be made available in due course. The Governor asked that, if any Members wished to suggest names of guests who might be invited to either the dinner or the lunch, they should contact Peter Rodgers as there were spaces still available.

The Governor then drew attention to the note and press release in Members' folders regarding the decision of the Bank for International Settlements Board to repurchase the non-voting shares in the BIS currently held in the private sector. The rationale was the tension between the private shareholders, who had purely a financial interest in their holdings, and the central bank shareholders who had a public policy function to perform through the BIS. At the Governor's behest, BIS management had confirmed their intention to recommend to the Board maintenance of the current dividend policy. This would mean that no change would be necessary to the basis of valuation (as a multiple of earnings) of the BIS shareholding in the Bank's accounts.

Mr Clementi reported on three items. First, as regards the new £10 note to be launched on 7 November, there would be two versions with a small variation between them: 400mn notes bearing the words "The Gov. & the Company" rather than "The Gov. & Company" had been printed before the mistake at the Printing Works had been picked up. The Bank had decided to proceed with both notes on the basis that the variation in detail was minor and unlikely to cause confusion; that, most significantly, the cost of printing the incorrect note had been approximately £14mn; and that Mr Berkowitz's advice had been that both versions of the note were legal. The Bank would be open about the two versions at the time of the launch and Press Office would be briefing to ensure that there was no confusion.

Mr Clementi acknowledged that this was a disappointing experience, revealing weaknesses in proofing both at the production end and by the customer (Issue Office), as well as in the speed at which the mistake and the proposed way forward had been brought to the attention of the Governors. Steps were being taken to ensure that there would be no recurrence. The Bank believed that, given the very small difference between the versions, the situation was manageable; but Court should be aware.

Mr Bailie said that he knew from experience how easy it was for printing errors to slip through. Sir Ian Gibson asked if anything similar had happened before, because that would be the first question the media would ask. Mr Clementi said he knew of one incident some years ago when incorrect dates were given for a historical figure featured on a note. He added that The Sun had got hold of the main facts and had been expected to publish them the previous day, but had apparently dropped the story when learning that they could not report destruction of the incorrect notes.

Turning to a happier story, Mr Clementi was pleased to report agreement on the sale of New Change, which Court had endorsed in principle at the beginning of the year. Of an initial nine bids, five were above the book value of £150mn and had been shortlisted. In the final analysis, the top two bids had been very close but Land Securities' offer of £178.6mn had been marginally preferred because it was higher and offered more certainty of prompt completion. Acceptance of the preferred bid had been recommended by both the selling agents and by Freshfields. Exchange of contracts was expected in early November and completion by the end of that month. In response to Ms O'Donovan, Mr Clementi confirmed that the purchase was for cash and he added that he would come back to Court with a proposal on how the money to be received would be dealt with.

Last, Mr Clementi drew Members' attention to the newly-launched Bank of England recruitment website, and encouraged them to visit it. As well as providing information, in four separate sections, about opportunities for experienced economists, graduates and post graduates, IT staff and A-level entrants, the site enabled on-line applications. Eighty genuine expressions of interest had been recorded in the first ten days.

Mr Plenderleith briefed Court on how MPC members envisaged the process of taking decisions about foreign exchange market intervention, if the need for such decisions arose. By way of background, he recalled that there was a general authority for the Bank to carry out intervention from its own resources at the behest of the MPC should the latter decide that this would be helpful for monetary policy purposes. This was separate from any intervention from the Exchange Equalisation Account, in which case the Bank's role would be to conduct the intervention operation as agent on H M Treasury's instructions. Exercise of the general authority for independent intervention by the Bank was subject to Court's approval of the financial aspects in view of the risks which would be carried on the Bank's balance sheet from open foreign exchange exposures. The Bank of England Act 1998 established a fairly complex structured procedure which the Bank had to follow in relation to decisions on intervention; following discussions in the MPC, an Aide Memoire had been produced, copied in Members' folders, which set out the proposed decision-making process. Four steps were envisaged:-

1. A policy decision, whether at a regular monthly or specially convened MPC meeting, that intervention should be undertaken for monetary policy purposes. The formal decision would be recorded, by vote, to authorise the Bank to undertake the intervention within any parameters specified, and not exceeding the limit authorised by Court. At the meeting, the MPC would also decide by vote on publication of the policy decision on intervention: the Committee might agree on immediate announcement of the decision or – if publication were judged likely to impede or frustrate the purpose of the intervention – to defer publication either temporarily to a specified date or sine die; in the latter case a further meeting to decide on publication would be needed.

2. Announcement by the Bank of the fact of intervention, probably with some explanation of the reasons for it, would be most likely at the time when the intervention operations were initiated; this might be soon after the conclusion of the MPC meeting or later if there were tactical or other reasons to delay the initiation of operations.

3. Publication of details of any intervention – timings, amounts and currencies involved – would be made in the regular monthly announcement of the UK's foreign exchange reserves on the third day of the following calendar month; this might fall any time between a few days and a few weeks after the intervention operation.

4. Publication of the MPC's decision and of the relevant minutes would follow according to whatever timetable had been decided at stage 1. In practice, this could either mean publication with the full minutes of the monthly meeting or separately, once the MPC had decided that the impede/frustrate condition no longer prevailed.

In conclusion, Mr Plenderleith said that the matter was not as complicated as might appear: in essence, the MPC – having taken the policy decision to authorise foreign exchange intervention – had to decide what should be published and when; and nothing in the Aide Memoire limited the MPC's discretion to take final decisions on how to proceed in the light of circumstances at the time. Responding to a question from Ms O'Donovan, Mr Plenderleith said that, once the Bank had intervened, the fact would be known to market participants but not the amount involved; the Bank would never comment on speculative questions about intervention in the future.

Baroness Noakes said it would be helpful for Court Members to be advised when intervention, whether from the EEA or the Bank's own resources, was publicised. This had not happened when the EEA intervention the previous month had been publicised, which had caused some awkwardness. The Governor said that the point had been raised already and was well taken. Members would in future be advised by e-mail or fax if and when intervention was publicised, as they were for interest rate decisions.

Mr Buxton queried whether, given the range of its membership, the MPC was a competent body to take intervention decisions, though he recognised that the Governor and some members were fully qualified to do so. The Governor responded that the monetary policy process necessarily involved the whole MPC and that it would not be right to delegate any aspect to another committee. In his view, all MPC members had a good appreciation of the likely impact of foreign exchange intervention decisions. He added that the Treasury had their own stock of foreign exchange which could be used for intervention purposes – usually in the context of concerted international action – and would consult the Bank on the consequences for monetary policy of such intervention.

The Governor observed that, for no logical reason, Court's authority for foreign exchange intervention from the Bank's own resources permitted only the <u>sale</u> of up to £0.5bn. While it was not a current issue, he believed that the authority should also cover purchases of sterling to the same limit, and he asked if Members would agree to this. In response to Baroness Noakes, Mr Plenderleith explained that the risks were the same either way. Court agreed that the Bank be authorised to buy or sell up to £0.5bn in foreign exchange market intervention in operations requested by the MPC.

Mr Neill asked to be reminded of Court's responsibilities in relation to intervention from the Bank's own resources. The Governor explained that, because the exposure would be taken on the Bank's balance sheet, Court had to agree the acceptable level of risk. Should the MPC consider that the current ceiling of £0.5bn was too low, the matter would come back to Court to consider a higher figure. If Court was not comfortable with what was then proposed by the MPC, there would be the option of approaching the Treasury for agreement to carry out the intervention from the EEA.

MANAGEMENT OF THE BANK
Quarterly Financial Report
(Executive Directors and Messrs Midgley and Footman in attendance)

Mr Midgley presented the Financial Report for the June/August quarter. Ms O'Donovan and Sir Ian Gibson commented how rare it was, in their experience, to see such a report showing income higher than forecast and expenditure below budget.

Mid-year Review of Performance
(Executive Directors and Messrs Footman and Midgley in attendance)

Mr Clementi noted that the Mid-Year Review covered the first six months of the year and was backward looking while next month Court would discuss a strategic and planning paper looking forward to next year. He said that the Bank had held a very good staff conference the day before and there was a full discussion about staffing and morale issues and a good look at the objectives. A number of points made by Heads of Division required following up. Mr Footman, commenting on the Mid-Year Review, said there would be a fuller version in March when the results would be available for the whole year. The book covered each business aim for each budget centre and most of the material came from individual managers within the units. They had broadly commented that objectives had been met or would be met in the current budget year. Some pinch points remained in MA. There would be a response to the Don Kohn review. He noted that there was more an issue of experience shortages than staff shortages, and the former were holding back a number of research programmes. On the other hand, the Schools' Competition had been launched successfully. In Banking and Market Services, C21 had been launched. In Personnel, the summer recruitment campaign had been launched and in a quantitative sense had been successful. A great deal of progress had been reported within Financial Stability, with particular focus on the success of the Financial Stability Review.

Baroness Noakes commented that the reviewing Director for the external MPC members was down as Court, which did not seem right to her, and she asked whether it would be looked at again. Mr Footman said there was an outstanding question of who should formally review the budget of the external MPC unit, which had not yet been resolved. It was to be one or other of the Deputy Governors. The Governor suggested that that could perhaps be left to the Bank to resolve.

In reply to a question from Baroness Noakes about possible delays in the decisions to be made on databases, Mr Clementi said more may be said on that in the November Court meeting. He noted the OCP work on coalitions, and said that in the coalition looking at analytical work Mr Jenkinson and Mr Tucker had been asked to collaborate to see if any of the procedures in MA could be used in FS, since the Bank would rather not have two databases with different architecture. Financial Stability management was saying that the requirement to talk was causing delay. Mr Clark said this was regarded as a major management issue and it was crucially important that the best use was made of IT.

In reply to a question from Baroness Noakes, the Governor agreed that Court should be updated on the Bank's own preparations for the euro and he said Mr Townend should join Court, perhaps after the next Practical Issues in November.

Mr Buxton said he believed it very important that there should be more co-ordination between different parts of the Bank with respect to IT, and one of the problems was that different divisions wished to go off on their own. In general the best outcome was to bring things together. The Governor said this issue was discussed at the Senior Staff Conference, and he was quite encouraged. Identifying the three coalitions was a very good way of doing it. The compromise which had to be sought was between holding back to await a collective solution or allowing some parts of the Bank to go ahead with full awareness, however, of others in the coalition. The Bank would report back on how that process was going. His general impression was that it was well advanced in Central Services and in Banking and Markets, and it was in the analytical coalition that the biggest difficulties occurred.

In response to a question from Mr Buxton about why apparent staff shortages continued in MA and retention problems remained, Mr Footman said that exit interviews were conducted with all who left, particularly in MA and FS. The message was almost always that it was not a question of money but a combination of reasons, usually to do mainly with expectation of how fast people would progress within the Bank, and their views of how much impact they would make inside compared with working outside the Bank. One commonly cited point was that an economist might be more likely to make an impact on the MPC by writing for the Financial Times or for a broker than working inside the Bank. Sometimes there was discomfort with management hierarchies within MA and the Bank. Sometimes people had come to the Bank with a view to getting five years of the Bank on their CVs and then leaving. The Bank was to some extent in that market. Mr Bean said that it also had to be recognised that the sort of people being discussed had high job turnover whatever institution they were working for, whether it be the Treasury, academic posts or the City. There were particular aspects related to the way MA operated and its input to the MPC, but the Bank would never get retention rates up to those which might be achieved for non-economists. This was something the Bank would have to live with. Mr Footman said that the Bank would like to have a few more years of such people, because it was losing their experience. The Governor noted that, in terms of numbers, the Bank was for the first time fully staffed with economists, but not with the experience levels it wished.

Court was up.

[illegible]

15 November 2000

Peter Rodgers

15 November 2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 NOVEMBER 2000

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

Ms Kathleen O'Donovan

As the Governor had not arrived when Court started, and in accordance with Schedule 1 paragraph 3 (3) of the Bank of England act 1998, Baroness Noakes took the chair.

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

Economic and monetary discussion, incorporating the monthly MPC Report to Court (Mr Bean together with Mr Allsopp and Drs Julius and Wadhwani in attendance)

Mr Bean noted that the Bank's official interest rate remained at 6% in November, where it had been since February. He said that there were clear signs that the US economy was slowing and it still looked on track for a soft landing, though the risks were heavily on the downside. At a turning point it was always difficult to judge how sharply the change would take place. Growth in the euro area had remained firm but there were signs of softening from orders data and from surveys. He noted that the HICP was at 2.8% in October. The recovery was continuing in Japan, but was anaemic, while emerging markets were recovering, though some, particularly in Latin America, were dependent on the outcome in the United States and on oil prices.

Turning to the domestic economy, Mr Bean noted steady above-trend growth with low inflation. Output was provisionally estimated to have grown at 0.7% in the third quarter and the National Institute estimate for the three months to October was 0.6%. There was a mild deceleration. The sectoral pattern had continued to be diverse, with industrial production falling by 1% in September and manufacturing by 0.4%. But some parts of manufacturing had been doing well. He drew Court's attention to a chart showing computers, electronics and communications growth compared with the rest of manufacturing. Turning to the near term prospects, he asked whether consumption growth would slow further. Could the race between fast-growing public expenditure be accommodated by slowing growth in private sector demand?

The pre-Budget report was expected to have little net effect on growth and inflation. The outlook was more uncertain than for some time, however. In the labour market, official data continued to paint a benign picture of developments, with the market apparently tight but earnings growth stable. The labour market was not continuing to get tighter at the rate it had been doing, and might indeed be starting to ease a little. Agents would be asked to find out more about pay pressures in their next issue of the month. Productivity growth, which had been weak by historical standards, had recently been reasonably good, and had risen to slightly above its long-term trend. Unit wage costs were growing at their slowest for five years. If the UK stayed in a world where earnings growth was subdued and productivity growth was high, inflationary pressures on the domestic side of the economy should remain relatively subdued.

Mr Bean noted that import prices fell 0.9% in October and RPIX rose 2% in October compared to 2.2% in September. The headline RPI was 3.1% compared to 3.3%. The main reason for the dip was petrol prices, but prices in general were likely to be volatile because of the effects of flooding on food prices and related issues. Mr Bean said there was now more uncertainty about prospects than in the recent past.

In Mr Plenderleith's absence, Mr Bean drew Court's attention to chart 1, showing the sterling exchange rate which he described as on a roller coaster. It had risen from 109 at the time of the last Court meeting to 111 before slipping back. Most of that was associated with moves in the euro. Turning to chart 2, he said that the ECB had intervened on a number of occasions but it did not seem to have had a noticeable effect on the euro, and the general view of the market was that this intervention had not been particularly successful. Mr Bean noted chart 3, for short interest rates, and said a key feature was that they had shifted down by ¼% a year out, implying that the market expected the next move in official rates was more likely to be down.

Turning to share prices, he noted slippages in the main indices in the US and the UK and said the US had experienced a major reappraisal of the prospects for high-tech stocks. NASDAQ was down 26% since the beginning of September.

Baroness Noakes asked whether Dr Wadhwani or Dr Julius had anything to add. Dr Wadhwani noted that Mr Bean had said that the rate of growth of high-tech spending had slowed very considerably in the United States and he wondered to what extent Members of Court had seen this in the UK as well. Sir David Cooksey said that across a series of companies with which he was involved there were distinct signs of slowing growth, and this was going to continue. Sir Chips Keswick said 2001 was likely to see a continuing downward revaluation of assets leading to a rise in gearing, and a particularly dangerous area was telecoms, where the bond market was freezing up. If access to equity was not available sooner or later there would be a credit crunch in the banking sense. Next year the market was going to probe real net asset values. Ms Blow confirmed a slowdown in the IT sector. Sir Ian Gibson noted that the US had been the main driver for the motor industry for five years, but was slowing, so that the US downturn was driving the downturn in the whole motor industry. He also said he was surprised by the tone of the Agents' Report this month because only the East Midlands toned with his observations, and the rest were far too optimistic. He had been visiting UK components businesses and had heard of rundowns, closures and walking away from new projects wherever he went. On motor industry sales, he said that he expected to see continued price pressure at least until the Spring, and most dealers were starting to withdraw from certain franchises.

Sir Neville Simms said he had a slight difficulty with what the Agents were saying as well, because they were reporting reasonably strong commercial activity. But cranes represented last year's orders and this year's orders were next year's cranes. Commercial building work was weaker than the Agents perceived and weaker than the official figures so far. On IT, his company and sector reflected the fact that the industry as a whole was late into the area and had catching up to do. Full order books encouraged companies to spend. There was more opportunity for business to business e-commerce.

Sir Howard Davies noted work that the Financial Services Authority had been doing on telecoms debt. It was clear that some banks had become somewhat over exposed to the telecom sector earlier this year in terms of bridging loans to finance third generation mobiles. In most cases they were able to sell down the debt, and only one or two had rather more than they would ideally want to have. He did not believe the FSA had found unexploded bombs, in terms of individual institutions. He noted that the high yield market was dead, and therefore telecoms companies were looking to banks for financing. One or two banks had said no, because they were not prepared to extend themselves further in the area, and some of the others were thinking hard about it. There was a hiatus in the market and people were not sure whether they could secure finance. He did not see it as the beginning of a serious downturn, rather it was a pause for reappraising the risks. He expected markets to re-open, and the underlying tone was alright. In the UK, there were signs of a pause in the Initial Public Offering market, which the FSA saw through its role as the listing authority. There was a large queue of issues for prospectus approval, but the issues seemed likely to be sat on until they were ready to go and the uncertainties were ironed out. He suspected that when the question in the US was resolved, about whether the markets would reopen with slightly different pricing, that would influence the UK position.

Mr Neill noted that in the car industry in October, there was an increase in demand from private buyers which was somewhat at variance with Sir Ian's report. But he in fact believed the overall situation was much worse. Reports from suppliers canvassed by his staff were scary. The scale of expected losses was quite extraordinary and there was talk of closures or moves out of the UK. He noted the decision by Honda to stop making a small car. Sir Brian Moffat endorsed what had been said. Even in the construction industry, for which his company was a first stage supplier, there was a dip in the order book sharper than had been seen for many years. This was quite worrying. In reply to a question from Sir Brian about the weighting of electronics, computing and communications companies against the rest of manufacturing in the chart Mr Bean had put before Court, Mr Bean said they comprised a relatively small proportion of output but the growth rate was very large so they had a big effect. Mr Stretton noted that, at the Glasgow Agent's lunch, he had been told by a manufacturer that many firms classified as in manufacturing were not manufacturing anymore. He wondered whether there could be a systematic overstatement of what was happening in manufacturing. Turning to IT investment, he said the financial sector was experiencing a squeeze on profitability and the only way to attack that was to improve processes, using IT. Mr Bailie said that his industry had not experienced the pressures of the automobile industry and was in a relatively satisfactory condition. There were no huge closures. In Northern Ireland the situation was good, and there were benefits from the expansion in the Republic. He would be more optimistic than his colleagues.

Mr King, turning to Sir Brian's point, said that what really mattered to the MPC was how much activity was taking place, not what label to put on it. In response to a question from Mr Allsopp about steel stocks in Europe, Sir Brian Moffat said he would send him a copy of the Eurofer Report for the third quarter. Most firms were taking measures to hold production back, to try to get stocks in better balance.

Non-Policy Meetings of the MPC
(Mr Bean together with Mr Allsopp and Drs Julius and Wadhwani in attendance)

There were no questions.

The Kohn Report
(Mr Bean together with Mr Allsopp and Drs Julius and Wadhwani in attendance)

[The Governor in the chair.] The Governor noted that the report was presented last month and had been discussed in the MPC, and these discussions were reflected in the note by Mr King. Mr King said the report was a major development in the procedures of the MPC, and for Court in monitoring the MPC. It had been extremely helpful in making the MPC think about a number of issues, several of which it had thought about before but needed to be jolted into thinking about again. Baroness Noakes had found 26 recommendations within the report, and this was very helpful for Court's discussion. Mr King said he had grouped the 26 in to seven headings.

Baroness Noakes said that these were not recommendations, and indeed Mr Kohn had said he was not making any. This was a list of points, and on some of them she was unsure whether Mr Kohn was making a comment or asking for a further response.

Turning to the first heading - the central message of the Kohn report that the process of addressing the issues raised must be pursued, Mr King said the MPC would continue to discuss and improve the process. He noted that Mr Kohn's view was that the most important of these issues was the forecast.

Turning to the second heading, research, where the proposal was that the research agenda must allow ideas to bubble up from the staff, Mr King said that a new procedure had been put in place almost a year ago for agreeing research priorities. Of the fifteen research proposals for the current year, eleven had come from staff submissions. Another idea that had come from the report was that more resources needed to be devoted to model development. The resources for model development would be reviewed in the next budget round.

Baroness Noakes, referring to the eleven staff submissions, said that staff felt they were being driven towards short or very long term research rather than medium term research. Mr King said that Mr Bean would be discussing these issues with Monetary Analysis staff in January. Staff would be made aware that some of the research was not for the next meeting but for meetings down the road. Mrs Heaton noted that the research review was an annual meeting and she asked how it linked with the quarterly round. Mr King said the quarterly meeting tackled urgent research that needed to be done, but was not meant to take away resources from items agreed at the annual meeting. The whole process was one in which the MPC itself decided priorities.

Dr Julius said Mr Kohn had picked up a lacuna in resources and procedures for the MPC's long term research. The quarterly meetings needed to be used not just for immediate priorities but should include some medium term research which could not be handled in the quarterly time frame but was quite important. These were issues that were a little too detailed to be resolved in the annual time frame. Baroness Noakes asked whether a timetable should be agreed for the circulation of research projects, because saying that it was necessary to do better, as the paper suggested, was hardly a sufficient response. Mr King agreed only that it would be sensible if papers could be circulated further in advance. Dr Julius said that a target should at least be instituted.

Turning to heading three, which covered the need for briefings of the MPC to be better focussed and more analytical, Mr King said there was a new timetable, the length of presentations had been restrained, there was better focus and more analysis. Staff focussed on the key points and did not feel they had to present all the material. Sir Neville Simms, commenting on his visit to a pre-MPC meeting, said that in his organisation he would have wanted to have heard more staff views though, perhaps with very senior staff, views could be got across on a one to one basis. Mr King said that the pre-MPC was for staff to present what had been happening. The MPC needed views and interpretations of statistics, not views on policy or big structural issues. The forecast round was the place for that. There were more opportunities for staff to say what they thought about the key economic issues in the forecast round. But those issues were not sensible for them to raise at pre-MPC.

Mrs Heaton said that if she were on the staff she would seek active dialogue and robust debate. Mr King said that was a good point but it should not be a debate about what happens to interest rates in the month concerned, but should be about economics. One difficulty with the staff was that they wanted to have a debate, and the MPC wanted to hear their views, but the staff were there to serve nine members, who had differences of view. The staff did not want to be seen to be aligning with one particular member. They had not one but nine bosses. That made it more difficult for them to take up clear positions.

Baroness Noakes said that Mr Kohn had picked up a desire among staff to do more, nevertheless. She did not believe staff were saying they were happy with where they had got to. Mr King said that in the new forecast process discussion was limited to a small number of big issues and the process had been designed to get more input from staff, by starting with a forecast by the staff. It was too early to judge the results and he would come back to report to Court after a couple of forecast rounds.

Dr Julius suggested thinking about other opportunities for exchange of views outside the policy process. It might be useful to try occasional special topics meetings about, for example, the labour market, to hear what the labour team really thought about the market. She would be very receptive to that. Sir Howard Davies said the purpose of the Kohn report was to help Non-Executive Directors feel the process was as professional as it could be, and that it was also in learning mode. He felt this was an extremely good exercise, particularly as Baroness Noakes had said that this was not a set of recommendations. Mr King's note was a fully satisfactory response to the report, which was holding up an intelligent mirror to the MPC. In twelve months time Court should come back to some of the points, particularly the one in relation to staff and the MPC. In his experience most economists had nine views so having nine bosses ought to be an ideal arrangement.

Baroness Noakes said that, while these were not recommendations, anybody who read the Kohn report could pick up points on which to ask questions. She agreed that anything not dealt with now should be brought back to Court in twelve months time. The Governor agreed.

Turning to heading four, the Agents, Mr King said their value was that they provided colour, flavour and tone rather than an alternative to the official statistics. Their input would never be representative of economic activity as a whole. For example, they did not focus on the public sector, and manufacturing was heavily over represented in their contacts. The Bank was always looking to improve this. The question of the month was a bonus for the committee. The Agents had a very important role in helping the MPC assess opinion around the country.

Baroness Noakes said that Mr Kohn thought the Agent's were doing a really good job. NedCo had discussed a number of issues including whether their results were representative, and some Directors would like to see their research quantified in time series. Mr Kohn's suggestion of research to establish how representative they were echoed some of the Non-Executive Directors concerns. Mr Buxton said he believed the Agents added value in the same way as Court in its discussions with the MPC. In his experience Agents did not have the time, and in some cases the knowledge, to get to the bottom of some of the issues. That was where Court had questioned what the Agents were doing. The Governor said it was necessary to be very clear about the purpose of the topic of the month. It could never be more than impressionistic and he did not regard it as intensive research. If it were to be done as research it would have to be at Head Office, because the Agents were not equipped for that. It was more like an opinion survey. Baroness Noakes said she suspected the work of the Agents was a topic to which Non-Executive Directors would want to return.

Mr King noted the importance of using the Inflation Report to convey a collective message and the minutes to convey individual decisions. Mr Kohn had agreed with that. The forecast represented the best collective judgement, the centre of gravity of the Committee, and the forecast had to be consistent with the decision by the Committee about interest rates. Mr Kohn wrote about a forecast of the majority, but it was not clear that there was such a thing as a single majority forecast. The MPC was trying to produce forecasts that gave an accurate picture of the balance of opinion within the Committee. He noted the table with key differences which was published in the Inflation Report. The MPC would keep thinking about where the balance was. It would learn more when the ECB published its forecasts.

Summarising a number of the changes, Mr King said the forecast was now described as centre of gravity of the Committee ; an examination of previous errors was done as part of each forecast round; the Bank now gave very much more of a role to staff; the round was started after the previous MPC meeting and not five or six weeks later; it was started with a benchmark forecast by staff; the MPC deliberated, with recommendations from staff, on three or four major issues; meetings then focussed on these issues; staff dealt with minor issues; the work was all brought together in two forecast meetings. This procedure kept the MPC focussed on the central projection and the key issues for the forecast.

There was one other issue: the suggestion from Mr Kohn that the MPC might think about a forecast based on its own views of where interest rates were going. The MPC however voted on interest rates each month. It was not sensible to vote on the next 24 months. Even if an arbitrary path were taken the world might interpret it as the MPC's view. He also noted that the MPC published a market forecast. It was not easy to know how to deal with this problem, which was widely covered in the technical literature. But the Inflation Report was for a wider public. The MPC believed a constant rate forecast had real advantages in those terms, but the issue would be discussed further. It was even possible that somebody would come up with a better solution. Mr Kohn had also said that the forecast horizon should not be restricted to two years. But Mr King said his understanding was that Mr Kohn was not suggesting publishing a forecast beyond two years.

Mr King said many of the suggestions by Mr Kohn had been implemented already as a result of discussions with him. Baroness Noakes noted that Mr Kohn had suggested a survey of users of the Inflation Report to discover what they thought about it. The Governor said that the Bank had tried to explain repeatedly the nature of the forecast. He noted the importance of communicating the content but perhaps a survey could wait a little while.

Sir Neville Simms said that, in his view, two or three of the points listed by Baroness Noakes in relation to Mr Kohn's report had been answered more defensively than they needed to be. He did not see why the Bank had to be defensive, because there was no evidence that what it was doing was in any way wrong. The Governor said he did not believe the MPC felt defensive. But there were dilemmas for every institution concerned with monetary policy.
Sir David Cooksey said he was pleased to hear that the Bank was comparing outcomes with forecasts but slightly worried that if that type of work was published it could set off lots of hares. The Governor said the Bank had started to publish the analysis of outcomes in relation to forecasts but had not had a long track record. There was positive merit in explaining ways in which the forecast was not quite right. Mr King believed that it was a mistake to publish numerical values for every item in the forecast because it would become bogged down in detail. It would also reverse the improvement gained for staff in relation to their MPC work.
Sir David Cooksey agreed.

Mr Morris said the report raised a host of questions that needed to be resolved about ownership of the forecast, about whether or not is should be a definitive forecast or a projection of the staff, about the number of constituencies, two or three at least which needed to be satisfied, and also about the much wider constituency - not users or practitioners - who had an interest in the report. There was also NedCo's interest itself. Everyone needed to understand who owned the Inflation Report and what it represented.

The Governor noted that Court had before it the response of the MPC, which had set out the changes it had made. It was proposing that the issues be kept under continuous review.
Mr King, returning to the forecast, said there were two pairs of issues. There were the very technical issues, about the right conditioning assumptions for the forecast and the mapping of the forecast to the policy decision. These were difficult issues for research and debate, and

would be thought about and developed as time went by. They were not issues of process. The issue of process was whether the MPC discussed and debated them and it did do so. Secondly, there were questions about who did the forecast, and that was partly related to ownership. There were lots of views about that. The Bank of England was probably the only central bank with a committee whose votes were known and which published a forecast. In terms of resolving the tensions between individual accountability and a collective message, the Bank was further down the road than anybody else. There was no easy answer. The current view of the Committee was that the forecast represented the centre of gravity. Baroness Noakes said there needed to be a public debate that would determine the acceptability of where the MPC had got to. She also noted that views changed over time. Mr Bailie agreed Court needed to have comfort that there was a debate about how the process was reviewed, and he was not sure that he wanted to revisit that issue every six months.

Turning to headings six and seven, covering outstanding issues in relation to MA and the MPC and pressures on MA staff, Mr King said that the first of the annual meetings on research issues had taken place and he believed there had been a great deal of improvement. The changes last Autumn had borne fruit. He also believed that the problem of pressures on staff had eased. There was an issue about salaries for economists. The Bank had introduced the position of Senior Economist. In the last 12-18 months it had managed to secure half a dozen senior economists and that had made a big impact. It had made clear to younger people that they did not have to become managers for further opportunities to exist. The Bank was looking at whether the scheme could be extended to Band 1. Baroness Noakes said this was another area that Mr Kohn wanted to highlight, and it should be kept under review. Sir Chips Keswick said the Bank was still constrained by the changeover in 1997 and the cost issues raised then, which were clouding the Bank's ability to pay high enough salaries.

Turning to procedure, the Governor said that Mr King had noted the intention was to publish the report before the Non-Executive Directors appeared at the Treasury Committee. There would also be a note based on Mr King's paper, translated into a narrative, and trying to make it less defensive in some areas. This would be published at the same time as the Kohn report. It would be discussed with the MPC and would be sent to Court members ahead of publication.

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

In updating Court on domestic Financial Stability matters, Mr Clementi noted that there would be a long discussion in December. Mr Clark would mention Argentina, which was a concern to the Bank. There was also a seminar on the coming Friday to look at high-tech firms, and that report would be published in January. The Governor suggested delaying the discussion until December.

Executive Report
(Messrs Bean and Clark in attendance)

Mr King noted that the competition started the following week with 36 regional heats over two weeks. Judges would be from the Agencies and Head Office. At the last count, 173 schools were in the competition. This was a good total for the first year.

The Governor asked whether there were any management issues arising from the Kohn Report. Mr King said that under headings six and seven Baroness Noakes had asked him to comment separately on the relationship between Monetary Analysis and the external MPC members. There had been improvements but some of the problems remained. Staff working for the "externals" thought that their future in the Bank may not be as good as if they had not accepted the posts, and therefore they felt they needed better conditions. These staff were securing promotions and higher salaries that were denied them while they were working in MA. The "externals" had also taken actions that affected the staff working for them. There was now a self-styled MPC Unit and they had launched their own discussion paper series without discussion with the Bank, and launched their own website as well. Staff in the Unit could publish their work instantly, whereas staff in MA were subject to a careful quality control process and external referees. It was building up to a feeling that there were two sets of managers for MA and you could chose who to work for. The situation was partly dependent on individuals. Mr King paid tribute to Mr Allsopp and Professor Nickell, who had brought in a lot of common sense. But there were still potential difficulties. The period of fraught relationships had gone. But he did not pretend that the structure was not still open to these problems and probably always would be, when there were energetic, full time people who wanted to play a management role. That would have to be made very clear when people were appointed.

Sir Brian Moffat said staff ought to have the same standards or rules whether they were inside or outside the MPC unit. Mr King noted that Mr Kohn had pointed to the danger of two parallel research operations. He noted that a benefit of the last 12 months was that there was no challenge to the scale of resources, and that change had worked well. But a parallel organisation had definitely developed.

The Governor said the Bank had made a mistake and should have given the external members resources in the first place. These had now been given. There was a sense that the "externals" were independent members of the Committee, and they had to demonstrate that independence. He hoped that over time they would come to recognise that there were nine independent members and their sense of needing to assert themselves would go away. The Bank had to continue working to smooth the situation. In the case of staff who were promoted, external MPC members had wanted to demonstrate that there was no disadvantage in working for MPC members, which had been the perception in some of MA. On the question of publication, he was content provided that external members made clear that the work had not been through the quality control process that the Bank maintained. Over time people would see there was less of a tension. A lot of progress had been made but there had to be continuing effort on both sides. The change of personnel had helped a great deal. Mr Allsopp and Professor Nickell were more sensitive to the issues.

Turning to the £10 note, Mr Clementi said there was good coverage. Material on the two variants of the note was included in the press packs and there was no press comment on it.

Mr Clementi said the Bank had reached heads of agreement with the Lawn Tennis Association to build a national tennis centre at Roehampton. The Executive of the LTA did not appear to be particularly well organised and it might take some time getting from heads of agreement to the contract stage.

The Bank's Strategy
(Messrs Bean, Clark, Footman, Midgley and Ms Lowther in attendance)

Mr Clementi noted that the process this year was rather different. There was more discussion in GovCo and ManCo. The coalitions had been working since August. The Staff Conference in October had debated a paper on strategy and objectives, and a working document had been produced. It lacked some of the crispness of recent years but was more interactive and there was a greater buy-in by senior staff. He noted the staff impact of changes over three years, as shown in Appendix 2, with Personnel and Property Services falling sharply. The rest of Central Services had fallen by a smaller amount. In particular Secretary's, responding to the higher profile of the Bank, was bearing an increasing burden in that area, including the Press Office and the competition for schools.

Mr Clementi noted that the IT proposals had developed from the OCP report, and said that it was proposed to update Court on this in February. A vigorous start had been made. In Appendix 3 he drew attention to 44 business priorities, 19 of which had IT input. Further work was needed to refine this list. It would be an important part of the budget process for Court in February. Change was bound to continue, but the assurance given to staff was that the Bank had no plans to change personnel policies themselves. There was to be a big push in the year on training and on building morale. There was a huge programme of work to improve output and process and this would put strain on resources. The Bank's external reputation was high, and there was a sense of achievement about what had been done in three years, and a sense of purpose for the future. If the paper was approved by Court it would be disseminated to all staff.

Baroness Noakes raised the issue of linking the prioritisation exercise with the financial objectives. Did the Bank invest out of efficiency savings elsewhere or did it have a desire to invest for the future? Mr Clementi said the Bank was well down the road to the financial objective of £20mn saving. Court had not agreed the budget, but the Bank needed to justify all it did on its own merits. It did not have to say that it must stay within a total of £212mn. But in practice it could meet analytical and IT needs while staying within that total. It was too early to have a firm view. The Bank was not giving absolute guidelines to each area but it wished to stay within the expenditure levels of 2000/01. The Governor said that Court would come back to these issues in February. The Bank had to satisfy Court with what it wished to do. He would not wish to be constrained to the point that the Bank would only expand in some areas if it contracted in others. It had an agreement with the Treasury but even that was not absolute in that CRDs could be re-negotiated. But the Bank would have to justify why it needed to go back to that question. He suspected that it was not an immediate issue for the budget but Court would discuss that in February. It was difficult to be precise until the Bank had a feel for what various parts of the Bank needed to do to meet their objectives.

Sir David Cooksey welcomed the discussion but said that an area of concern was whether there was an overlap between Financial Stability and the FSA. He asked how the boundary was defined and how much overlap there was. The Governor said it was defined by the MOU. He did not feel there was a significant overlap. Sir Howard Davies noted that the paper said that clarity about the Bank's responsibilities had grown. Initially there had been uncertainty about how it would shake down but in the forums in which the Bank and the FSA worked together, the most important of which was the Basel Committee, it worked quite effectively at all levels. The Governor and he himself discussed Basel issues, and members of the committees had divided up the work between them effectively. There was probably work to be done on payments and settlements and how that was divided. A stone had been thrown into the pond by the Cruickshank report which left things a little unclear. It was not known whether there was going to be a payments regulator but this would not be a responsibility of the Bank or the FSA. But overall the relationship was right. He noted the work of the Tripartite Standing Committee. It might help at some point to clarify this work and give more information about it to Court. The Committee had been very helpful and its work underpinned the MOU. It had proved to be a very active forum. Activities had fallen out quite naturally as from the FSA or from the Bank. Perhaps the Bank and the FSA together could produce a note on the issues taken at the Committee. Mr Clementi suggested this should include what the Standing Committee does and how it operated. Sir David Cooksey said this would be extremely helpful. The Governor said he was impressed by the way understanding macro-level financial stability was developing in the central banking world, partly driven by evolution at the Bank of England. People had been very interested in the separation. This was reflected in the interest in the Financial Stability Review. At meetings he had attended, he had discovered Canada and others were very interested in publishing their own FSR.

Mr Buxton said he was pleased at the emphasis on IT. He was glad the Bank was following the OCP recommendations. It was not only that an IT champion was needed in ManCo but there was also a need for a mechanism to bring coalitions together. There would be issues that crossed the three coalitions. An IT champion would bring discipline into these coalitions to ensure that the Bank had a common policy across all three. Mr Clementi said the head of MSD would stand above all three coalitions.

In response to a question from Baroness Noakes about why staff motivation had been added as an objective, the Governor said that this meant more to him, within the strategy and objectives, than anything else. If the Bank did not restore staff motivation and morale, the excellence it was striving for would be totally undermined. Mr Neill agreed.

Court APPROVED the Bank's Strategy and Objectives for the year 2001/02 and noted that matters relating to the budget would be considered at Court the following February.

Issues arising from the euro
(Messrs Townend, Bean and Clark in attendance)

In introducing his paper, Mr Townend noted the business aims of the Co-ordination Unit for Europe. These were co-ordination of the Bank's euro related work; providing a body of knowledge and expertise on the ESCB; contributing to the Bank's relationship with the ECB and national central banks; representing the Bank on European issues in official and public sector forums; monitoring and reporting on practical issues arising from the euro and the euro market; and co-ordinating City preparations for entry. He described a number of aspects of CUE's work in more detail.

The Governor said that the work was being handled extremely well. He noted the difficulty in maintaining morale which arose from the perception that membership was moving forward in time. But Mr Townend had succeeded in maintaining morale very well.

In response to a question from Baroness Noakes about retail preparations, Mr Townend said the banks had said they needed up to three years to prepare fully. The key was to identify what needed to be ready at the point of entry and what might be done later. In the second national changeover plan the Government had begun to talk about a phased approach. Wholesale markets would move to the euro on the day of entry but retail financial services only at a point some time afterwards, at least for those who could not do this from the outset. This approach was potentially very helpful. If it worked, all the preparations could start at the same time, then wholesale could come on-stream at entry with a delay for a period for retail financial services. The work CUE had done with the banks had not identified insuperable problems to this approach. It was quite likely the Government would want to pursue it.

Mr Buxton said the banks had stuck to a three year timetable. As time went by they were altering their systems anyway, and so the change would probably become easier. He noted that on the Continent people were not switching until they were forced to.

Ms McKechnie said she was concerned about the time consumers would be given to adjust. The Consumers Association believed quick was better. The longer dual pricing lasted, the more confusion there would be. She cited a mess in the metric switch over. She asked that lessons should be learnt from other countries' experience. Mr Stretton said that the long-term savings business had problems which were probably worse than those for the banks. Customers would determine themselves what the new timescale was. He was not sure that learning from history was the right approach. Other countries had a standing start whereas the UK would be joining late. Mr Townend said he was in touch with the insurance sector and had encouraged them to keep in close touch with their in-country peers to find out what the issues were in, for example, dealing with historic data. There was a great deal to learn in banking and other sectors and the Bank was trying to encourage people to do that, by saying "this is important now", and emphasising that it would be too late if it were left to the transition period. The issues and how they were being tackled should be on the record. The Governor thanked Mr Townend.

Court rose.

[illegible]
20 November 2000

Peter Rodgers
20 December 2000

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 20 DECEMBER 2000

Present:

The Rt.Hon Sir Edward George, Governor
Mr King, Deputy Governor - Monetary Policy
The Baroness Noakes, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mr Buxton
Sir David Cooksey
Sir Howard Davies
Sir Ian Gibson
Mrs Heaton
Sir Chips Keswick
Ms McKechnie
Mr Neill
Ms Kathleen O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Mr Clementi, Deputy Governor - Financial Stability
Sir Brian Moffat
Mr Morris

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

MONETARY STABILITY ISSUES

Economic and monetary discussion, incorporating the monthly MPC Report to Court and including international economic developments
(Messrs Bean, Clark and Plenderleith together with Professor Nickell and Messrs Allsopp, Jenkinson and A Bailey in attendance)

In introducing the monthly MPC report to Court and the minutes of the meetings of the MPC held in November and December, Mr Bean said that the central projection of the Inflation Report showed inflation a little less than target but picking up towards target, with growth around the level of underlying productive potential. The report recognised that the background was one of considerable uncertainty, both internationally and domestically.

Presenting his paper on the international economic environment, Mr Bailey said that the evidence of the last two months pointed to a more pronounced slowdown in the world economy, and particularly in the US. Most forecasts, including the Inflation Report, had predicted a slowdown in the US for a considerable time, but had been wrong. The Inflation Report had contained a downside risk from the US stock market for quite some time. But over time most forecasters had scaled back their expectations of a slowdown.

Mr Bailey noted four themes in relation to the US. First, the US economy was widely regarded as out of balance in a longer run sense, which led to questions about the extent of the slowdown needed to bring it into balance, about the sustainable rate of growth and about the rate of productivity growth, including the extent to which the increase reflected cyclical elements. Second, and related to this, was the sharp fall in equity prices particularly in the IT sector. A key issue here was the link from stock returns to investment, especially in ITC, and that could have a particular link to Asia where growth recently had slowed and, outside Japan, had become very dependent on exports. Third, there was a question about how far the tightening of financial conditions was a general issue, or whether it related to particular sectors, for example telecommunications. He noted that in a period of rapid structural change it was always expected that there would be winners and losers. Fourth, a sharper slowdown in growth in the US could prompt a slowdown of capital inflows which would have implications for current account financing, and potentially for the dollar. Mr Bailey also commented that the dog that had not barked was inflation in the US. The oil price shock had pushed up current inflation but not expectations.

Turning to the euro area, he noted signs of slower growth but these had been accompanied by a pick up in inflation, which was continuing. The ECB was less sure about inflation expectations, though a data series comparable with the US series was not available. Mr Bailey noted signs of financial fragility in Argentina and Turkey, but the markets were differentiating more among emerging market economies than in 1997-98. Nevertheless a sharp slowdown in growth in the US and in world trade would have a large impact on the world economy.

Mr Bean noted that official interest rates were again unchanged in December, following a vote of 7-2 in the Monetary Policy Committee. Two members voted for a reduction. Rates had been unchanged since February, the longest period without a change for ten years. There had been some de facto monetary easing, because the markets had priced in future cuts, probably next Spring, as chart 1 showed. He noted that the exchange rate index had been more or less unchanged since the last Court, though there had been movements against individual currencies. On activity, the ONS had confirmed that third quarter GDP had risen 0.7%, but there was new information in the composition of demand. In particular consumption was growing more strongly than the Bank had expected. Investment and government spending were a little lower than expected. The mix of more consumption and less investment was disappointing, looking forward. Investment in manufacturing had been subdued, which was not surprising, while the extent to which services investment had dropped in 2000 was something of a surprise. It did not square with survey evidence. He also noted that government spending was running lower than the Bank and the Treasury had expected. There was a question about whether there would be a burst of public expenditure towards the end of the year as Departments tried to spend up to their limits.

Turning to the labour market and inflation, Mr Bean said employment growth had continued to slacken. The underlying trend growth was at roughly the same speed as labour force growth, so unemployment had stopped falling and had stabilised. The tightness in the labour market had not got worse. On pay rounds, the indications from surveys and from the Agents were that there might be some acceleration in settlements but nothing too severe. He noted the inflation figures, and said that near term expectations were that RPIX would remain a little less than target.

In commenting on the markets, Mr Plenderleith said there was a distinct softening of the dollar, which was evident from chart 2. The counterpart was some recovery in the euro. There was a feeling that it may have been oversold in mid-year. But the moves were moderate, at around 5%. There was a question about whether the movements would become sharper, and with some overshooting. He noted that the yen had weakened further against the dollar. Turning to bond yields, in chart 5 he noted a distinct easing in yields world-wide in recent weeks. The most likely reason must be indications of slower growth looking ahead. He was not sure whether it was telling us what had already been seen or whether the markets were saying that something worse was ahead. He noted significant, but not huge, falls in US, euro and sterling yields.

In response to a question from the Governor about whether they wished to add anything, Mr Allsopp and Professor Nickell declined.

Mr Buxton said that the bank borrowing figures supported Mr Bean's views. Personal borrowing was remarkably strong. But there were few signs of financial strain through repossessions or bankruptcies. Mr Buxton also noted an overall increase of 15% this year in corporate borrowing, concentrated in particular sectors such as hotels, restaurants and leisure. In summary, he was surprised by how well personal borrowing, particularly short term, had held up, and while corporate borrowing was slowing the rate of growth was falling much less than he had thought it would.

Mr Neill said that while his last report to Court had been gloomy it had in fact turned out worse. Assemblers and component manufacturers were closing and profits were evaporating. Losses for the motor industry would be about £3bn. In the US, sales were almost at a record but profitability was evaporating and the industry was very worried about next year. His sense was that it was not a soft landing but a crash landing and that it had happened about three weeks ago. Telecoms was different, with reports of sharp increases in sales. He would not be surprised if more car and component makers departed from the UK in the next 12 months or so. In response to a question from the Governor, Mr Neill said the UK was having the worst time, but that was going to spread, in production terms, to the United States and Continental Europe.

Sir Neville Simms said the construction industry was in reasonable shape with regard to output. He noted that forecasts for the industry assumed a substantial increase in repair and maintenance work, but he was nervous about whether this would come through, because previous predictions of strong growth had not been born out, and R and M tended to stay very close to 44-45% of the industry's output. On infrastructure orders, they were clearly needed but there was a question over whether there were people available to carry them out. His company maintained 30% of the railways, and it was not a question of more people doing more but prioritising the existing resources. He noted that leisure, another main driver of the construction industry, was coming off the top. Housing, which was never more than 15% or less than 10% of the industry and was currently about 12%, was not a very big driver.

Mr Bailie, recalling that the month before he had been more optimistic than his colleagues from the motor industry, noted a fall in confidence. People believed that it was not going to get better and possibly was going to be worse, and year end budgets were focussing minds on difficulties and problems. A number of companies he spoke to were talking about job sharing in the next quarter, and were considerably less optimistic than in June or July. Tourism figures were down quite considerably.

Sir Ian Gibson, returning to the problems of the motor industry, said UK dealers were starting to show publicly the effects of price reductions because they were facing write downs of used cars inventories. The UK was experiencing the fastest rate of withdrawal from the business for 12 years. Many dealers were leaving, and a lot of others were trying to change brands. There was a belief in the industry that it was going to run short of dealers, which was the reverse of the picture two to three years ago. In major cities margins were not high enough to encourage start ups. Turning to the world economy, he noted an interesting conflict in Japan. In part because of the weakness of the yen, most manufacturers of cars and electronics were sitting on more margin than they had forecast at the start of the year. On the other hand there was unease about whether the domestic recovery was going to disappear once more. He noted that the US motor industry felt that it had gone over the edge of a cliff. There were some extremely profitable lines with high margins and a lot of products that were not selling at all. A number of plants were on short time. The recent fall in oil prices had supported the purchase of larger engined vehicles, but there was uncertainty about whether a future rise in oil prices would snuff out growth.

Sir David Cooksey said that higher retail sales were coming through but at the cost of very deep discounting. The sales had started in mid-December this year. There were going to be a lot of very disappointing profitability numbers coming through. Some banks might become quite cautious about lending to the sector early in the new year. There were a number of warning signs. Turning to the TNT sector he noted that suppliers to the mobile phone industry were scaling back their numbers for next year.

Ms Blow said that the IT services sector expected growth to halve from about 20% to 10%. There was concern about the rate at which growth would settle in the future and she believed that the first quarter picture next year would make this clearer. In reply to a question from Mr Allsopp, Mr Neill noted that nearly-new car prices had fallen 20% and used car prices by more. The impact on dealer profitability would lag as a lot were sold through lease schemes where the residuals would be lower. It would be seen in the profitability of dealers in the next two to three years. A company such as Lex might find costs of perhaps £90 mn as a result. Sir Ian Gibson said second hand prices were still declining whereas in the nearly new market recent changes were already in the pricing. He expected a lot of smaller dealers to go out of business.

Mr Buxton said he did not believe negative equity was a big problem for private individuals but it was a problem for motor dealers with stocks, and also in the car rental industry, where guaranteed buy-back prices were a feature.

MPC Procedures:-
Procedures adopted by the MPC to meet its mandate
Provision of regional and sectoral information to the MPC
(Messrs Bean, Clark and Plenderleith together with Professor Nickell and Messrs Allsopp and Jenkinson in attendance)

Mr King noted that the papers before Court were the first of a sequence over the winter, ahead of the production of the Non-Executive Directors' Annual Report. He drew attention to an extra page on the priorities the MPC attached to statistical work, which was to be sent to the ONS. In response to a question from Mrs Heaton about the process for agreement with the ONS on statistical issues, Mr King said that the MPC would send an accompanying letter setting out its views. The ONS had to take as inputs the views of other departments, not least the Treasury. This was less an overall resources question than a matter of managerial emphasis. The ONS had given a good deal of attention to the priorities that the MPC had set out last year. The MPC did not have grounds for complaint. Mrs Heaton commented that it would be useful for Court to be advised if there were areas where there were differences of opinion. Baroness Noakes said that Mr King's remarks suggested that the MPC did not get full delivery on some requests. Mr King said some matters could not be dealt with in one year. For example, the MPC still had some questions on the average earnings index. These points had been made at working level. With the best will in the world there were bound to be some issues where the ONS could not make much progress. But he did not believe there was any serious issue.

Mrs Heaton commented that, as well as knowing the priorities for next year, Court needed to know about performance over the last year. Mr King said perhaps the Bank would come back to this question next year with a brief paper. In response to a question from Ms Blow, Mr King said it would be up to the Chancellor to allocate more money if statistical resources were thought to be insufficient. He believed that, so far, the ONS was delivering. Mr Cook had only been in his new position for a few months and was taking a considered look. Mr King was loathe to complain until Mr Cook had done so. Mr Cook wanted to make changes - for example, Mr King believed he was puzzled by the lack of uniformity in briefings given ahead of statistics, and both he and the Bank were very keen to make this uniform. Mr King noted that lots of bodies had a valid interest in statistics in the UK, and it was not just a question of what the Bank of England wanted. There was a conflict between what the Bank of England required on a macro level and the need for micro-economic statistics. There was now a Statistics Commission, an oversight body, and if the Bank felt that one area was neglected it could draw the matter to the Commission's attention. The Governor noted that the Bank had a very good relationship with the Chairman of the Statistics Commission. He did not sense that there was anything the Bank would want to take up on either front.

In response to a question from Baroness Noakes about the Agents' table, Mr King said that he did not believe it was disadvantageous to the MPC to have an over-representation of manufacturers. This was partly because a large faction of services were in the public sector and there was access to much information on that. Also, part of the role of the Agents was to explain what the MPC was doing to the local community, and in the last three years it had been well worth making more effort to explain the MPC to manufacturing. Baroness Noakes commented that the information given to Court showed a comparison of Agents' contacts by sector, based on numbers of businesses. Her understanding was that the number of businesses was not a good way of measuring value. Mr Jenkinson said he took some solace from the fact that the numbers represented a very large number of contacts. That gave him some comfort that it was reasonably representative in terms of small versus large. It was hard to know what the target should be and how to adjust for the public sector, though he noted that the targets were not exactly set by the proportion of GDP represented by the sectors. There was some weighting. In practice, the Agents' contacts were under-represented among very small firms and his concerns would be in that area. The Bank had shied away from employment weighting. Mr King said that ideally there would be a value-added measure. That could be possible where they visited a complete firm, but in many cases they were talking to local representatives. He believed that the Bank should talk to the Agents about this and come back to Court. The Governor agreed. He noted that in the monthly Agents' enquiry the Bank did get information on employment and turnover.

FINANCIAL STABILITY ISSUES
Financial Stability Review, together with domestic developments and international issues (Messrs Bean, Clark and Plenderleith in attendance)

In introducing the latest edition of the Financial Stability Review, which had been published the previous week, Mr Clark noted that there had been a modest increase in risks in the financial environment over recent months. The period had seen a widening in corporate credit spreads and a significant downward adjustment in equity prices. But these adjustments were, in some senses, not unwelcome and the risks of instability should not be exaggerated: banking sectors in the major countries were well capitalised and the latter's financial systems remained generally robust. He highlighted three factors contributing to the assessment of increased risks – the slowdown in the United States, the re-emergence of pressures in some emerging market economies and the substantial build up of debt in the telecoms sector.

On developments in the United States, Mr Clark endorsed the analysis which Mr Bailey had given earlier. The central question for anyone currently assessing the risks to financial stability concerned the impact of a sharper-than-expected slowdown in the US economy given the build up of private sector and external debt and the uncertainty about returns in the new economy. The tentative conclusion was that equity prices seemed to be more in line with the estimated change in productivity performance; but there were still uncertainties about other variables – other asset prices, savings behaviour and exchange rates.

As regards problems in the emerging market economies, Argentina and Turkey presented the most immediate risks. The former had been a potential problem for some time, caused by slow growth, a weak fiscal position and a sclerotic labour market; the currency board arrangement removed a degree of freedom but had been crucial in restoring some measure of nominal stability. Argentina needed to refinance some $25bn of debt in each of the next few years. A new IMF programme was in prospect in January and would cover immediate needs. But the uncertainties over the longer term position meant that Argentina would remain a concern for some time to come. For Turkey the problems centred on the banking sector and the exchange rate regime. An IMF Board discussion was scheduled the next day and Mr Clark expected a programme to be agreed. UK exposures were not great in either country. The banks involved had been prepared to rollover financing without too much difficulty, but with less explicit linking to IMF programmes than he would have liked to see.

With regard to telecoms, the financial sector had provided some $300-400bn of funding over the last few years. This evidenced the capacity of the financial sector but there were risks in such exposures, particularly to an industry where developments were unpredictable. This was why the Bank and the FSA had sought to flag up the issue as one of concern for regulators, central banks and financial authorities and for the financial sector in general, without generating self-fulfilling worries; so great care was being taken to pitch the indications of concern at the right level.

Mr Clark also mentioned that, while the FSR had not, in the current issue, majored on Japan, that country was still a source of concern. Consumer confidence was weak, the prospects for growth looked less secure and the capacity of fiscal policy to keep the economy moving might be called into question by the accumulation of government debt.

Commenting on the articles in the Review, Mr Clark noted that they reflected the general intention of giving a more quantitative flavour to the Bank's FS work. He drew attention to two articles which explored aspects of the reliability of leading indicators in helping to flag up possible financial instability.

Mr Clark next updated Court on the work of the Standing Committee. He recalled that it comprised representatives of HMT, the Bank and the FSA, and had been set up in 1997 within the framework of the tripartite MOU to discuss general developments and individual cases of significance for financial stability. The Committee - although it could be convened at any time if circumstances demanded - typically met monthly, normally at Deputy level. Court Members' folders contained a list – not exhaustive – of the topics which had been addressed. He noted that it was not a policy-making body but was in the main a forum for the exchange of information and for flagging sensitivities, with follow-up action lying with whichever institution had prime responsibility for particular issues. There had, as yet, been no test of the Committee's crisis handling.

The Governor commented that he saw the development of the Bank's financial stability role over the past two years as a tremendous success. The Financial Stability Review had become a classic document for other central banks and for those in the financial market place and he congratulated Alastair Clark, David Clementi and the staff involved in this. People now looked positively to the Bank as a role model for financial stability as well as for monetary policy issues.

Sir Chips Keswick raised concerns about South Korea. Mr Clark replied that the Bank's internal Financial Stability Committee had discussed the situation there at its last but one meeting: the foreign exchange reserves position had strengthened but there remained much to do on corporate reform.

Mr Stretton noted the rising of spreads in the derivatives markets and asked whether the Bank's intelligence on exposures was adequate. Mr Clark acknowledged that it was sometimes hard to get hold of information; the Bank was particularly trying to build its knowledge in relation to credit derivatives and securitisation. He believed that the capacity to redistribute risk via derivatives was helpful provided that people recognised concentrations in their ultimate exposures (which had, for example, not happened at Lloyds). He added that an increasing amount of credit risk was seemingly being transferred to the insurance market.

On Turkey, Mr Buxton said that defects in financial supervision had been the major contributor to the current problems. He hoped that the IMF would take the opportunity to encourage recent initial efforts to build up the supervision role. While the immediate cause of the difficulties was an outflow of capital, the underlying problem was inadequate capitalisation of banks. There were some 70-80 small banks around, many of them dubious, and tackling the problem was essentially a political issue. Current support operations were a huge cost to the Turkish

Treasury. The big banks operating in the country would support a strengthened supervisory regime.

Mr Clark said it was recognised that supervision was weak and that around ten banks were already subject to support measures. The IMF was adopting a two-prong approach, addressing the macro-economic and the supervision problems. The Governor added that an aggravating factor was the new regulator's insistence on the closure of foreign exchange exposures by the end of the year. Mr Buxton agreed that the Turkish authorities were doing some things wrong through inexperience; they needed help in establishing a basic system of supervision.

Mrs Heaton asked for information on the UK Government's new initiatives on money laundering. Sir Howard Davies replied that there were both legislative and case specific developments. The latter concerned Abacha's activities when President of Nigeria, the investigations into which had recently achieved high profile in the media. The main accounts were in Switzerland and the Swiss investigation, as well as making reasonable criticism of Swiss banks, had pointed to the UK as the original channel for the outflow from Nigeria. This was misleading; in practice, two thirds of the payments had reached Switzerland via Jersey and most of the rest through a European-supervised bank in the UK. The investigation into what had happened in this country was being led by the FSA.

On the legislative front, the Financial Services and Markets Act contained new powers which, when implemented, would allow the FSA to prosecute in cases of suspected money laundering. At present the FSA's role was merely to ensure the operation of the system under which banks reported suspicious transactions to the NCIS. A second legislative initiative was to strengthen government powers to confiscate the proceeds of financial crime through the establishment of a national confiscation agency. Sir Howard Davies added that consideration was also being given to extending the money laundering rules to cover financial institutions not authorised by the FSA, especially the cheque clearers and bureaux de change; the current debate in Whitehall was whether to proceed and, if so, where the responsibility should lie.

In response to a question from Mrs Heaton about the size of the money laundering problem, Mr Clark said there was no evidence of any impact on financial stability; that might occur if confidence was affected because of the size of an institution apparently involved.

FINANCIAL MARKETS OPERATIONS ISSUES

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

Mr Plenderleith drew Court's attention to the paper, circulated the previous week, on the Euro Note programme. He recalled that, at its meeting on 15 March 2000, Court had agreed the proposal that the Bank should take over from HMT the latter's Euro Note programme from January 2001. The paper before Court sought formal authority for the Bank's Euro Note Programme and the issues to be made under it.

By way of background, Mr Plenderleith explained that the Treasury's programme was started in 1991 with the aims of increasing foreign exchange reserves and developing the euro (then ecu) paper market in London. The Treasury had decided to end its programme – in which the Bank was involved as agent – and instead to finance the foreign exchange reserves by increasing sales of gilts, with the sterling proceeds of the latter being switched into euro. The Bank saw merit in taking over the programme, at its own liability:-

1. in order to maintain a UK official sector presence in the euro markets;
2. in order to help promote trading of euro paper in London; and
3. because the business was profitable.

The programme would permit the issue of euro-denominated interest-bearing notes with an aggregate principal amount outstanding at any one time of €6.6bn (some £4bn) at maturities of up to three years, to be sold by quarterly auctions and subsequently traded through some 20 listed market makers. The aim was for a seamless transition from the last auction of Treasury Notes held in October to the first auction of Bank Notes in January 2001. The one material change was that the programme would in future impact on the Bank's balance sheet – the notes as liabilities and the proceeds as assets; there would be matching in euro terms and thus no foreign exchange exposure.

It was proposed that the Notes would be listed for trading on the London Stock Exchange, for which the Financial Services Authority (FSA) was the Listing Authority. This necessitated the preparation of listing particulars under the Financial Services Act 1986 and compliance with the FSA's content requirements. As the Notes would constitute international securities for these purposes the provisions of the Financial Services Act 1986 imposing individual responsibilities for the listing particulars on Members of Court would not apply and the FSA would only require a corporate (rather than individual director's) statement of responsibility in the listing particulars. Both Freshfields and the Bank's internal legal advisers had been involved in the preparation of the listing particulars and other documentation. An Information Memorandum prepared by the Bank would constitute the required listing particulars. It set out the terms and conditions of the Notes, the auction arrangements, details of the Bank's constitution and function (including details of Court) and related information of interest to would-be investors or required by the FSA. Given the status of the Bank, its statutory obligation to prepare and publish audited accounts and the availability of the last two Annual Reports for inspection, no financial information was contained in the Information Memorandum.

Sir Howard Davies noted that, as Chairman of the FSA, he would ultimately be responsible for decisions on listing the Notes. From his viewpoint, Court's approval of the Bank's Euro Note Programme would not prejudge decisions on listing, which would need to be considered by the FSA in the normal way.

In response to a question from Mrs Heaton, Mr Plenderleith said that no additional staff would be required: the workload was essentially the same as for the Treasury's programme which the Bank's Programme was succeeding.

COURT RESOLVED THAT:-

A The establishment of the Bank's own Euro Note Programme (the Programme) pursuant to which the Bank would issue interest-bearing euro-denominated Notes up to an aggregate principal amount of €6.6bn with maturities of up to 3 years, to be sold by way of auction, be approved.

B Each person for the time being holding the office of Governor, Deputy Governor or Executive Director of the Bank be and is hereby severally authorised to do or perform, or cause to be done or performed, all acts or things as may be considered necessary or expedient in connection with the establishment and operation of the Programme and the issue of Notes under it, including:-

(i) the approval on behalf of the Bank of all documents which may be required to be published, executed of signed by or on behalf of the Bank (including, without limitation, any listing particulars, supplementary listings particulars, pricing supplement, Note or other document) in such form as such person may in his or her absolute discretion consider necessary or desirable;

(ii) the execution, whether under seal or otherwise, by or on behalf of the Bank, of any document required for the Programme or any issue of Notes including a Deed of Covenant and any Note in such form or as such person may in his or her absolute discretion consider necessary or desirable;

(iii) authorising all necessary applications to the Financial Services Authority for Notes issued under the Programme to be admitted to the official list of the UK Listing Authority and to the London Stock Exchange plc for Notes to be admitted to trading; and

(iv) approving issues of Notes under the Programme in such amounts and with such terms as such person may in his or her absolute discretion consider necessary or desirable.

Turning to the November gold auction, Mr Plenderleith said that there had been some apprehension in the run up following the disappointing result in July, although September had been a little better. In the event the auction had been well covered, with a good range of bidding; the price set had been above the then current market rate for gold. He added that the Bank was consulting participants in the auction to check that the arrangements were pitched right, and would be discussing the outcome of these consultations with the Treasury. He also reported that the National Audit Office was reviewing the gold auction process, looking at both the Treasury's exercise of its responsibilities and the Bank's conduct of the auction process. This review had involved a lot of work, including setting up meetings for the NAO with auction participants. He would report to Court on the conclusions in due course but was encouraged by the tenor and content of the draft report produced by the NAO.

[redacted]

Mr Plenderleith noted that the Bank has issued, for discussion in the market, a draft code on "non investment products". This arose because, for certain wholesale investments for which there was no statutory regulatory framework, the FSA had asked the Bank to produce a non-statutory framework for wholesale products including gold. The document circulated was based on the London Code already in place for activity in that area.

Executive Report
(Messrs Bean, Clark and Plenderleith in attendance)

Mr King mentioned two items. First he reported that the first round of the Target 2 Point 5 monetary policy competition for schools had been completed with considerable success. Although a number of schools had dropped out, 167 had participated in 35 heats in different venues across the country and standards had been high; most but by no means all of the teams had opted to argue for no change in interest rates. The competition had generated a lot of local publicity and one item nationally, and The Times was continuing to produce fortnightly briefings on relevant topics. MPC members would be involved in the regional finals in February and in the national final to be held at the Bank on 23 March and chaired by the Governor. Mr King highlighted the crucial contributions to the success of the competition made by two staff in Secretary's Department – [redacted] excellent resource material, which was available on the Bank's website and had been widely welcomed as a most useful package for all economics and business studies teachers; and [redacted] who had been involved since the competition's inception almost three years ago and who, with her team, had planned and co-ordinated the raft of arrangements needed.

Turning to opinion polling, Mr King noted that the first year's experience had been worthwhile. A paper would come to Court early in 2001 but the broad results of the polling showed recognition of the Bank's responsibility for setting interest rates, support for low inflation but less understanding of the transmission mechanism. To address the latter, two questions in the poll had been changed and were being trialled; they would be reassessed in February. All being well there would then be a stable set of questions for the foreseeable future.

The Governor drew attention to a letter in folders from Andrew Crockett at the BIS which sought support for the establishment of a new International Accounting Standards Committee and a UK contribution of $50,000 pa. He saw the proposals as an important initiative for financial stability issues and was in contact with Sir Howard Davies on how to respond. Subject to the decisions of other leading central banks and other financial regulators, he anticipated that the UK would agree to offer support as requested.

MANAGEMENT OF THE BANK

Report on the Treasury Committee Hearing
(No visitors in attendance)

The Governor reported that he had been in correspondence with the Chancellor of the Exchequer over Court appointments from June 2001 and had encouraged the Chancellor to come to a presumptive view of what he had in mind because of the need for timely activation of the Nolan process for public sector appointments. The Chancellor had recently responded that he was minded not to renew the appointments of Baroness Noakes, Andrew Buxton, Frances Heaton and Sir Chips Keswick but to ask Sir David Cooksey to remain and to take over as Chairman of NedCo. The Governor said he wanted to advise Court of these developments ahead of the launch of the Nolan process; there would, of course, be opportunities in due course to mark the contribution of those Members of Court who would be stepping down.

With reference to a Treasury Committee hearing on 12 December attended by herself, Bridget Blow, Sir Ian Gibson, Frances Heaton and Sheila McKechnie, Baroness Noakes said that most of the questions had focussed on MPC procedures. There had been little discussion on the Bank's objectives and strategy and none at all on gold or the euro. The session had been a low key one, with a number of Treasury Committee members absent. The range of questions had been predictable, covering regional and sectoral information, MPC resources and staff morale – which the Non-Executive Directors had stressed was a Bankwide issue and not one confined to Monetary Analysis. One member of the Committee had focussed on the non-attendance of the Non-Executive Directors at the monthly MPC meeting. The counter arguments to this had been made robustly but the Committee's take on the matter would only be known when their final report was published. Some time had also been spent on issues raised by the Kohn Report and the Committee noted a concern that Don Kohn had not himself sat in on a full MPC meeting. Baroness Noakes said that, in her view, there should be a minimum three year gap between such reviews and that the terms of reference for the next one should be looked at very carefully at the outset.

[redacted]

Ms Blow endorsed Baroness Noakes' impression that the Committee had been struggling to find worthwhile questions. She was disappointed that the only press report had majored on the staff morale issue; and she believed that, on this, Committee members had shown a lack of understanding of business issues and management processes. When the Bank promulgated the results of the current attitude survey, she hoped that the opportunity would be taken to highlight that the issues which the Bank faced were common throughout business and that management was aware of and addressing them.

On the question of the MPC, the Governor re-iterated the importance of the process of the monthly-decision making meeting. What was important was the discussion of monetary policy issues, not making an impression on non members, and the dynamics would be altered if observers were present. Mr King agreed and indicated that MPC members were themselves of the same mind. He also noted the highly market-sensitive nature of the information discussed. [Sir Howard Davies left the meeting.]

Recommendation from the Chairman of the Remuneration Committee
(No visitors in attendance and the Governor and Mr King withdrew)

In accordance with Schedule 1, paragraph 13 (5) of the Bank of England Act 1998, the Governor and Mr King withdrew and, in accordance with paragraph 13 (3) of the aforementioned Schedule, Baroness Noakes took the chair.

Sir David Cooksey reported on a meeting of the Remuneration Committee held earlier that morning. He said that the Committee had reviewed the Governor's recommendations for salary increases payable with effect from 1 January 2001 for the members of the Executive – the Deputy Governors, Executive Directors, Advisers to the Governor and external MPC members. The Committee had been pleased, for the first time, to receive copies of performance appraisals and objectives for members of the Executive and the Governor had agreed to look at whether the latter could be more closely tied to the Bank's objectives. Sir David also noted the Committee's concern that salaries for the Bank's Executive were becoming more and more distant from those for similar appointments. While the Governor believed that the Bank could not compete in the broader market and that Treasury were appropriate comparators, the

[redacted]

Committee had wanted to take the matter forward and the Governor had been persuaded to accept a comprehensive salary study to be started in the New Year and repeated in the following two years. This would pave the way for the next major opportunity to look at the salary structure for the Bank's Executive when the next Governor was appointed in 2003.

Turning to proposed salary increases for 2001, Sir David said the Committee had agreed the following recommendations:-

(i) A 5% increase for Ian Plenderleith and Alastair Clark; and a 4.1% increase for Charles Bean and John Townend to take their salaries to the base level of £140,000 for Executive Directors previously recommended by the Committee. (Sir David recalled that BenefitSelect applied to the Executive Directors and that the proposed salary increases would also apply to their benefit allowances.)

(ii) A 5% increase for Sir Peter Petrie.

(iii) A 2.5% increase for the Deputy Governors and the external MPC members, whose salaries were linked to the inflation target, as was the Governor's.

(iv) Implementation of the above increases with effect from 1 January 2001.

Sir David added that no increase was proposed for Mr Berkowitz and Professor Brealey, both of whom were leaving the Bank early in 2001.

Court noted and APPROVED the recommendations.

Sir Chips Keswick asked where matters stood with the proposal to increase benefits for widows under the Court Pension Scheme; the Governor had had reservations when the question had come up and the matter had been remitted to RemCo. Baroness Noakes recalled that the question had been held over while the proposal to merge the Court Pension Scheme with the Staff Pension Fund was being pursued; although the latter proposal had now been shelved, the widow's benefit question had not been picked up. Sir David Cooksey undertook to arrange for the matter to be included on the agenda for RemCo's meeting in February.

Court was up.

Noakes
17 January 200

Peter Rodgers
17 January 2001