

Publication date: 26 January 2000

---

---

# MINUTES OF MONETARY POLICY COMMITTEE MEETING

## 12 and 13 January 2000

---

---

These are the minutes of the Monetary Policy Committee meeting held on 12 and 13 January 2000.

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0001.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting held on 9 and 10 February will be published on 23 February 2000.



## **MINUTES OF MONETARY POLICY COMMITTEE MEETING ON 12-13 JANUARY 2000**

1 Before turning to its immediate policy decision, the Committee discussed the world economy; money and asset prices; demand and output; the labour market; prices and costs; and other considerations relevant to its decision.

### **The world economy**

2 The Committee considered developments in the world economy since the publication of the November *Inflation Report*. Outside Japan activity in Asia had strengthened perceptibly, as it had in the euro area, which was the single most important market for UK exporters. According to the most recent estimates, euro-area GDP had increased by 1% on a quarterly basis in 1999 Q3, with growth in the previous quarter revised up to 0.6%. The recovery now seemed to be spreading to Italy and Germany, in the latter case confirming the more buoyant picture shown by business confidence indicators and orders data, both of which had risen further in recent months.

3 GDP growth in the US in 1999 Q3 had been very strong, at 1.4% on a quarterly basis. More recently, in December US consumer confidence, as measured by the Conference Board, had risen to its highest level for over 30 years, and non-farm payrolls had continued to increase rapidly. While labour market data suggested considerable pressure on resources, this was not reflected in the capacity utilisation measures themselves.

4 Although both oil and non-oil commodity prices were rather stronger than had been expected in November, there had as yet been limited pass-through into prices further along the supply chain, particularly at the retail level. This might reflect lags, or the persistence of spare capacity in the world economy, putting downward pressure on margins. Alternatively, it might be related to stronger productivity growth, especially in the US. Following the extensive revisions to past data, most estimates of trend GDP growth in the US had been revised up. Equity prices might also suggest that expectations of sustainable growth were stronger than previously, but it was too soon to be sure whether such a rerating was valid, or whether stock markets had overshot on the upside.

5 To the extent that the rise in the price of technology stocks reflected expectations of rapid improvements in productivity, the boost to demand associated with the rise in share prices might be

greater, at least in the short run, than the supply-side effects from higher future productivity. The extent to which the rise in the price of technology stocks may have affected consumption was unclear, although increases in wealth more generally helped to explain the low US personal savings ratio.

6 The Committee discussed the implications of these developments for the US balance of payments. If trend growth in the US were indeed higher, the present current account deficit might narrow once the improvements on the supply side, which were perhaps already being anticipated by higher demand, began to feed through. If these improvements did not materialise, portfolio investment and capital flows linked to mergers and acquisition business could rapidly reverse, especially if stock markets fell back, with a risk that the dollar might decline sharply.

7 The Committee concluded that while the risks from a fall in stock markets and from current account imbalances remained significant, these had been present for some time and had not changed in degree over the past month or so. These risks aside, the outlook for world economic growth was now stronger than it had been, and the recovery in Continental Europe, which seemed to have become more firmly based over the past month, was of particular importance to the UK through its prospective effects on net trade.

### **Money and asset prices**

8 Narrow money had surged in December, with notes and coin increasing by more than 4½% in the month, and with the twelve-month growth rate (of 12½%) at its highest for twenty years. This appeared to reflect end-year or end-millennium effects, including greater-than-normal stocking of ATMs and higher cash holdings by the public. A sharp reversal in the level of notes and coin now seemed to be under way in January. The Committee agreed that these movements were unlikely to have wider implications for the rest of the economy; both these and the pattern of retail sales around the turn of the year might be examples of seasonal or millennium 'fog' which obscured the underlying position. By contrast, once allowance was made for the weak growth of deposits by Other Financial Corporations (OFCs), the underlying growth in broad money was rather stable, at around 6%.

9 M4 lending to households had again been strong, with the twelve-month growth rate the highest for eight years, and the Bank's estimate for mortgage equity withdrawal had been revised up

to £3.8 billion in 1999 Q3. 'Borrowing for consumption' – a measure which combined estimates of mortgage equity withdrawal and unsecured lending – was at nearly 5% of disposable income in Q3, its highest level since late 1990.

10 The housing market remained buoyant, with prices rising some 13½% over the last year on both the Halifax and Nationwide measures, and with house price strength now more widely spread across the UK than before, although significant regional differences remained. Measures of turnover and housing activity showed a less clear trend, however, and a survey of house prices by the Royal Institute of Chartered Surveyors (RICS) for December recorded a rather lower figure for the balance of estate agents reporting a rise in house prices.

11 Two-year interest rates had risen by around 30 basis points since the December meeting. The rise in interest rates had not been offset by a rise in inflation expectations. Other things being equal, the rise in real interest rates along the yield curve would tend to dampen demand, including via its effect on new fixed-rate mortgages. So monetary conditions in the UK had clearly tightened over the past month. This might in part reflect the stronger prospects for world economic activity.

12 In addition, the effective exchange rate index had risen by around 1¼% over the month. This would exacerbate the impact on net trade of the earlier appreciation, although it would be offset at least in part by the pick-up in world demand. Meanwhile equity prices in the UK had been rather volatile, rising during December and then falling back, but on balance were little changed over the month, and remained well above the central projection in the November *Inflation Report*.

### **Demand and output**

13 The latest National Accounts data included revisions for the period from 1998 Q1. While estimates of the level of GDP in 1999 Q3 were little changed, growth in 1998 Q4 had been revised down, with more of a recovery in the following two quarters. GDP at constant market prices was now estimated to have grown by 0.8% in 1999 Q3 (as against the previous figure of 0.9%) but the year-on-year figure had been revised up to 1.9% (from 1.8%).

14 Household consumption was still estimated to have risen by 0.6% in 1999 Q3, but the level of consumption was now 0.6% lower than previously estimated, in part reflecting a downward revision to expenditure on cars earlier in 1999 following the changes in the seasonal pattern for vehicle

registration. Business investment had fallen in Q3, and growth in investment as a whole in the quarter was barely positive. Within the total, manufacturing investment continued to fall, perhaps reflecting past pressure on margins, and there had also been a slight decline in investment by the services sector, after previous estimates had been revised up to show more rapid growth over the previous year. It was possible that some of the weakness in business investment reflected a pause in IT spending ahead of the new millennium. Government investment had increased sharply in Q3, although it remained well below planned levels. The level of government consumption expenditure had been revised down, though growth in Q3 was stronger than previous estimates.

15 Final domestic demand in Q3 was now estimated to be 3.2% above its level of a year earlier, compared with 4.1% in Q2, a figure which had itself been revised down from 4.5% in the previous estimate. Moreover, it seemed unlikely on present indications that year-on-year growth would pick up significantly from the 3%-3½% range either in 1999 Q4 or the present quarter. While such growth was likely to be too high to be sustainable in the long run, it was significantly lower than the 4%-4½% rates reported earlier in 1999, before the latest revisions had been made. The quarterly growth rate of final domestic demand had slowed more sharply, from 1.2% in 1999 Q1 to 0.4% in Q3, which if it persisted would no longer be above its sustainable rate. However, surveys and other evidence suggested that it could pick-up in Q4.

16 While final domestic demand growth had fallen back, net external demand had been stronger in Q2 and Q3, making a positive contribution to GDP growth on a quarterly basis (though this might not continue into Q4). As a result growth in GDP on a year ago was only 0.7 percentage points lower in Q3 than growth in domestic demand, compared with a gap of 2.6 percentage points in 1999 Q1. To that extent the recovery was now better balanced. The stronger performance of net exports might, if sustained, tend to put pressure on resources unless domestic demand growth continued to moderate. However, there was spare capacity in many export and manufacturing sectors following their recent downturns.

17 There was also some evidence of better balance in the economy from the output data, with both manufacturing and industrial output up 1.2% over the previous quarter in Q3, while the services sector had grown by 0.6%. Such a recovery in industrial output was consistent with the upturn in external demand from Continental Europe; but the slowdown in services, which was in part due to lower growth in the financial and business services category, was less easy to explain, unless it reflected a pause ahead of the new millennium.

18 Growth in retail sales volumes (which excluded spending on vehicles) continued to slow on a three month on three month basis, while still running at around 4% at an annual rate. As always, it was difficult to gauge the underlying pattern of sales over the Christmas and New Year period, and it would be sensible to look at data for December and January together when these became available. This was even truer this year, given the uncertainties over the impact of the millennium date change. However, most of the determinants and indicators of consumption (such as real labour incomes, financial and non-financial wealth and household borrowing, as well as consumer confidence) appeared either to be strengthening or to have remained strong, suggesting that consumer spending might continue to grow relatively rapidly in the near future; this was in line with survey data on retail sales for December. But car sales seemed to be weak, with some consumers apparently delaying purchases in the hope that prices might fall sharply in the near future.

### **The labour market**

19 Whole-economy headline earnings had risen by 4.9% in the year to October, with private sector earnings up by 5.1%. The headline figures represented a three-month average; taking the data for October alone, whole-economy earnings were up 5.1% on a year earlier, even though October was not a month in which bonus payments were typically large. There could be further upwards pressure on the Average Earnings Index in the next few months, if bonus payments were unusually high, for instance for millennium-related reasons. In any case, the figures for October suggested an upward revision to the profile for earnings contained in the central projection in the November *Inflation Report*.

20 There was some evidence of a recovery in labour productivity in the most recent data, at least part of which was expected for cyclical reasons. The *Inflation Report* had built in a recovery in productivity growth, and the increase seen in Q3 provided some support for that assumption. But unless productivity continued to improve, or pressure on margins intensified further, or the exchange rate continued to strengthen, stronger nominal earnings growth would lead to higher inflation in the medium term. Other indicators of wage pressure were more mixed, and as usual for the time of year there was little new information on settlements.

21 Employment had continued to increase, but at a rather slower pace than in the previous two months, with Labour Force Survey (LFS) employment up 0.2% in the three months to October compared with the previous three months, and other survey data also pointing to slower growth.

Unemployment had fallen again, but on the LFS measure had remained at 5.9%, with some of the rise in employment reflecting, in an accounting sense, a reduction in the numbers of those previously inactive who wanted a job. The Bank's regional Agents continued to report that skills shortages had – at least in some areas – increased further but evidence the previous month from both the CBI Industrial Trends survey and the recently introduced CBI/Deloitte Services survey had suggested that skilled labour shortages were still below historical averages. Figures for turnover in the labour market, constructed from P45 job separation data, suggested that job creation might be increasing in gross terms. A weighted index of employment in manufacturing, services and construction based on data from the Chartered Institute of Purchasing and Supply (CIPS) suggested continuing, but rather modest, growth in employment in December, in line with other surveys, such as that by the Recruitment and Employment Confederation.

22 The Committee agreed that the labour market remained tight, and that in underlying terms earnings growth was becoming uncomfortably high, particularly if productivity growth did not pick up further. This strength might be exaggerated by erratic factors (such as unusually large one-off bonuses) in the coming months, part of which might be millennium-related.

### **Prices and costs**

23 Despite the path of labour costs and oil and other commodity prices, retail price inflation remained subdued, with RPIX growing at 2.2% in November, below the 2½% target for the eighth month in succession. The strength of the exchange rate was one possible cause; another was the impact of competition (including via the Internet) which might act to restrain prices. Such 'e-tailing' was now being talked about as increasingly important not just for goods such as books and CDs, but was also seen as likely to become more important for other sectors such as electrical equipment and cars. By shortening the supply chain e-tailing might drive down costs for consumers who bypassed the distributors, and depress margins for the more traditional retailers and other intermediaries. An overall reduction in distribution costs through greater business-to-business e-commerce might show up as higher productivity in coming years. Alternatively, the effects of such competition might prove either to be transitory or merely to redistribute profits between retailers; and reports of squeezes on margins at retailers might suggest that some of these adjustments had already occurred.

24 The Committee noted that the inflation expectations of the general public, as measured in the latest Barclays BASIX survey, had increased in Q4, the first increase since 1998 Q3. However, since

the inflation measure was not specified, this might be no more than a reflection of the widely-expected rise in the RPI measure of inflation, which included mortgage interest payments.

### **Other considerations**

25 The Committee discussed whether the change of millennium had given rise to problems of data interpretation, over and above the normal difficulties in identifying underlying developments over the Christmas and New Year period.

26 At its previous meeting, the Committee had reaffirmed that there was no reason for the Y2K period to constrain monetary policy setting in the UK, and had also noted that it was unclear whether any 'fog' around the year-end would be much thicker than usual. So far any Y2K uncertainties had indeed appeared to be rather limited. While some figures had clearly been affected, such as the narrow money data, adjustments could be made to take account of the distortions. The pattern of retail sales was not yet clear, but this was typical at this time of year. The prospect of the new millennium might have had some impact on investment, for instance in IT, though this remained unclear. That said, many of the backward-looking data were still for periods before the turn of the year, so further distortions in the data might perhaps be expected.

27 The Committee also noted that during the next month it would carry out a new quarterly forecast for the February *Inflation Report*. This would allow it to analyse some of the puzzles in the data in more detail, such as the continuing coexistence of relatively subdued retail price inflation, above-trend growth in demand, and a pick-up in earnings growth and commodity prices. To the extent that uncertainties surrounding some of these issues might soon diminish in a way which informed the policy decision, there was a case for waiting until this had been done. But to the extent that the news since the previous meeting warranted an increase in rates, there was no reason for a delay, and some members of the Committee had felt that a rise in rates had been needed already in December.

### **The immediate policy decision**

28 The external environment for the UK had strengthened over the past month, as had most of the determinants of domestic demand, including wealth, labour income and household borrowing.



At the same time, final domestic demand in Q3 had slowed, and inflation remained below the 2½% target. The Committee discussed the implications of these developments.

29 On one view, the repo rate should be increased by 25 basis points this month. Various considerations were advanced to support this view, with different members of the Committee placing differing weights on the factors identified.

30 For some, the choice this month was between raising rates by 25 or 50 basis points, but on balance there was no need to move by more than 25 basis points now. Since the previous meeting, the change in the economy had not been dramatic. The strengthening in the outlook for the world economy, especially in the euro area, had produced better balanced growth in the UK, but meant that domestic demand growth would need to slow further from its present 3%-3½% annual rate if it were to be sustainable. In addition, a more generalised pick-up in world activity might place further upward pressure on commodity prices. While the very fast growth in narrow money in December seemed largely to reflect transitory factors, the credit figures were more of a concern. The sharp pick-up in borrowing for consumption, from 2% of personal disposable income at the start of 1999 to almost 5% in Q3, coupled with house prices and equity prices well above the central projection in the November *Inflation Report*, would tend to support robust consumption growth. This would put upward pressure on inflation in the future, despite a further rise in sterling and a welcome recovery in estimates of productivity growth to rather closer to the long-run trend. With annual retail sales growth remaining around 4%, further pressure would be placed on resources in the short term if investment recovered following the millennium change. In addition there was now some evidence that the tightening in the labour market was beginning to feed through into earnings. Average earnings in the private sector were growing at more than 5% on a year earlier, implying earnings growth well above the central projection in the November *Inflation Report*. Nevertheless, with inflation at present subdued, the costs of waiting a further month before deciding whether a further change in rates was going to be needed were small; the February *Inflation Report* provided an opportunity to carry out more analysis. Given the uncertainties, a tightening of policy this month by 25 basis points was the appropriate response.

31 Other members of the Committee agreed that an increase of 25 basis points was needed this month, but felt the outlook, particularly for inflation, was rather more benign. The pace of domestic demand appeared to be slowing and the recent news on GDP growth was in the surprisingly strong export figures, where the economy still had considerable room for growth. Inflation was still

expected to remain below the 2½% target for some time. Sterling had strengthened further, and some thought that it might rise even more, which would help to restrain prices. So too might structural changes in the economy over a number of years, perhaps reflecting stronger global competition and greater price sensitivity of consumers as a result of the enhanced price transparency brought about by Internet use. It was plausible that the growth of business-to-business e-commerce would lead to a significant reduction in costs. Average earnings might rise further in coming months, but this would partly reflect one-off factors such as bonuses; it would be important also to look at settlements data, as well as further micro-economic evidence on margins and productivity. It was also suggested that if the neutral level of real interest rates were around 3%, as some historical work suggested, and inflation expectations were firmly anchored at 2½%, a neutral nominal rate would be around 5½%. Given the strengthening of the world economy and many of the determinants of UK consumption it was appropriate for monetary policy to be tighter than neutral at present, but not by a great deal, especially given the strength of sterling, and this justified a 25 basis point increase in the repo rate.

32 On another view, an increase of 50 basis points was needed now. The recovery in the world economy and the remarkable strength in the principal determinants and indicators of consumption – such as real wages, secured and unsecured credit to households, wealth, and consumer confidence – suggested that in the absence of a tightening in monetary policy GDP would continue to grow above trend. Against this background the slowdown in final domestic demand in Q3 might well prove to be erratic. Given the strength of nominal earnings growth, it seemed likely that, in the absence of a stronger exchange rate, significant further improvements in productivity growth, or an intensification of the squeeze on margins, greater upward pressure would be placed on inflation in the medium term, even though at present RPIX was rising at less than 2½%. An increase in rates of 25 basis points had been needed last month, and given developments since then more was needed now. The arguments for waiting a further month, for more data and the analysis underlying the February *Inflation Report*, were insufficient reason for delay: an increase of 50 basis points in the repo rate was required this month.

33 The Governor invited members of the Committee to vote on the proposition that the Bank's repo rate be increased by 25 basis points to 5.75%. Eight members of the Committee (the Governor, Mervyn King, David Clementi, Charles Goodhart, DeAnne Julius, Ian Plenderleith, John Vickers and Sushil Wadhvani) voted for the proposition. Willem Buiter voted against, preferring an increase of 50 basis points.

34 The following members of the Committee were present:

Eddie George, Governor

Mervyn King, Deputy Governor responsible for monetary policy

David Clementi, Deputy Governor responsible for financial stability

Willem Buiter

Charles Goodhart

DeAnne Julius

Ian Plenderleith

John Vickers

Sushil Wadhvani

Gus O'Donnell was present as the Treasury representative.

## **ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF**

A1 This Annex summarises the analysis presented by the Bank staff to the Monetary Policy Committee on 7 January, in advance of its meeting on 12-13 January 2000. At the start of the MPC meeting itself, members were made aware of information that had subsequently become available, and that information is included in this Annex.

### **I The international environment**

A2 The global economy had continued to strengthen. Growth in the United States and in the euro area had been robust in Q3; the Japanese economy however remained fragile. There had also been further signs of a strengthening of the recovery in Asia and a turn around in Latin America. But it was not yet clear whether some of the strength in activity in Q4 was related to Y2K effects, which would be unwound in 2000, or reflected more permanent developments. There were still few signs of global inflationary pressure. Oil prices had fallen back somewhat in early January from the levels achieved in November and December. Interest rates implied by futures contracts had increased in the United States, Japan and the euro area since early December.

A3 US GDP growth in Q3 had been revised up further on an annualised basis, but the quarterly growth rate was unchanged. Investment growth in Q3 had been revised down to 1.7% from 2.0%. Investment in equipment and software had been strong in Q3, increasing by 3.7%. Consumer confidence had risen to 141.4, the highest since its all-time high of 142.3 in October 1968. Consumer confidence had been positively correlated with equity prices in recent years. US non-farm payrolls had risen 315,000 in December after a rise of 222,000 in November; the unemployment rate had remained at 4.1%. Annual consumer price inflation had remained at 2.6% in November, although core CPI inflation had risen to 2.2% from 2.1%.

A4 Euro-area GDP had risen by 1.0% in Q3. Final domestic demand and net trade had both made significant positive contributions to the rise in GDP. In the three largest euro-area economies (Germany, France and Italy) there had been a similar pattern of quarterly growth in Q3. Euro-area industrial confidence had increased in December, while consumer confidence had remained unchanged. German industrial production had increased 2.0% in the year to November, following an increase of 1.3% in the

year to October. Strong growth in German manufacturing orders, increasing 12.5% in the year to November, and a pick-up in the IFO survey measure had suggested a further strengthening in activity. Euro-area unemployment had remained at 9.8% in November. Annual inflation in the euro area had risen to 1.6% in November, from 1.4% in October. The rise in inflation mainly reflected higher energy price inflation.

A5 Japanese GDP had fallen by 1.0% in Q3 but was 0.9% higher than a year earlier. Private demand had remained weak in Q3; private consumption had fallen by 0.2% and non-residential investment had fallen by 0.3%. According to the December Tankan survey, enterprises' view of business conditions had improved, although manufacturers' sentiment had improved by more than that of non-manufacturers. Retail sales had fallen by 2.4% in November, a decline of 2.9% on a year earlier. The unemployment rate had fallen by 0.1 percentage point to 4.5% in November, although measured unemployment continued to be depressed by rises in inactivity. The consumer price index had fallen by 1.2% in the year to November, but excluding food had fallen by only 0.2%.

## **II Monetary and financial conditions**

A6 Narrow money had grown very rapidly in December. Notes and coin had increased by 4.6% on the month, after adjustment for seasonality and the introduction of the new 50p and £2 coins. The twelve-month growth rate had risen to 12.5%, the highest since 1979. Anecdotal evidence had suggested that a large proportion of December's growth reflected increased holdings by banks and building societies; in particular, ATM stocks were thought to have been higher than normal for the time of year. But the size of these additional bank holdings had been uncertain. ATM withdrawals had also been consistent with higher cash holdings by the public than over a typical Christmas period.

A7 The stock of M4 had risen by £2.6 billion (0.3%) in November, and the twelve-month rate had picked up slightly to 3.2%. The weakness of M4 reflected the fall in deposits by the other financial corporations' sector (OFCs) in November, but the M4 holdings of private non-financial corporations (PNFCs) had again risen strongly. M4 lending (excluding securitisations) had grown by £9.7 billion (1.0%) in November, and the twelve-month growth rate had risen sharply to 8.4%. Strong borrowing by households and OFCs continued to drive this robust lending growth.

A8 Households' M4 deposits had risen by £2.6 billion (0.5%) in November. M4 lending to households (excluding securitisations) had grown strongly, rising by £4.8 billion (0.9%) in November. The twelve-month growth rate had picked up to 9.2%, the highest rate since 1991 Q2. Within total lending to individuals, total net secured lending had risen by £3.8 billion (0.8%) in November, and the twelve-month growth rate had increased to 8.2%. The value of loan approvals had remained strong (at £10.4 billion). The stock of outstanding loan approvals had fallen (by £0.5 billion) for the first time since January 1999. This was thought to reflect both the relative strength of gross lending and a rise in cancellations in November.

A9 Total unsecured lending had risen by £1.3 billion (1.2%) in November, but the twelve-month growth rate had declined again (to 13.4%) and had fallen by more than 4 percentage points in the past year. The Bank's estimate of mortgage equity withdrawal in 1999 Q3 had been revised upwards to £3.8 billion and 'total borrowing for consumption' (defined as mortgage equity withdrawal plus unsecured lending) grew strongly.

A10 The M4 deposits of PNFCs had risen by £1.6 billion (1.3%) in November, and the twelve-month growth rate had picked up to 7.3%. In contrast, M4 lending to PNFCs had risen by only £0.3 billion (0.1%) in November, and the twelve-month growth rate had declined to 3.1%. But PNFCs' total borrowing (including foreign currency borrowing and capital market finance) had increased, with sterling capital issues being particularly strong.

A11 OFCs' M4 deposits had fallen by £1.5 billion (-0.9%) in November, and the twelve-month growth rate had declined further to -7.0%. But M4 lending to OFCs had risen strongly, by £4.6 billion (2.2%), and the twelve-month growth rate had picked up sharply to 11.4%.

A12 Nominal interest rates from gilts had risen between 30 and 50 basis points on the month, across all maturities. Short-term nominal forward rates at maturities up to five years had initially fallen following the December MPC meeting, but had subsequently firmed. Rising interest rate expectations, particularly at the long end, had also been evident in other countries over this period. Corporate bond spreads had narrowed since the beginning of January. Real interest rates derived from index-linked markets had shown little change at the short end, rising slightly at longer maturities. Survey-based measures of short-term real interest rates had also shown a slight increase in 1999 Q4.

A13 Quoted retail rates data suggested that the November rate rise had been fully passed through to time deposit rates, but only partially passed through to sight deposit rates. The November rate rise had now been fully passed through to standard variable mortgage rates. The rate on new fixed rate mortgages had risen a little, despite falls in swap rates of the same maturity.

A14 Implied forward inflation expectations had risen slightly, mainly reflecting the firming of nominal interest rates. Changes in survey-based measures of inflation expectations had been, overall, quite mixed over the month, but had shown a small increase in the general public's inflation expectations over the next two years.

A15 Over the month UK equity prices had exhibited volatility, rising before year-end and subsequently falling back. A similar pattern had been observed in other international equity markets. The FTSE All-Share index had been broadly unchanged since the December MPC meeting, but it had been 7.5% above the November *Inflation Report* level.

A16 The sterling effective exchange rate index had appreciated by 1.3% on the month, and had been 2.6% above the November *Inflation Report* central projection. Over the month, there had been little change in sterling against the euro, but sterling had appreciated against the dollar and yen. Monetary news had not appeared to explain much of these movements, since global interest rate expectations had for the most part risen in parallel.

### **III Demand and output**

A17 Quarterly GDP growth at constant market prices had been revised down by 0.1 percentage points in the third quarter to 0.8%. Revisions to previous quarters had reduced growth in 1998 Q4, but stronger growth in the first half of 1999 had left the level of GDP in Q3 little changed. Domestic demand growth had been revised down by 0.2 percentage points to 0.5% in Q3. This had been partly offset by the contribution made by net trade, which had been revised up from 0.2 to 0.3 percentage points. GDP in Q3 had been 1.9% higher than the same quarter a year earlier, revised up from 1.8%. Revisions to previous quarters had changed the pattern of annual GDP growth slightly, leaving the trough in 1998 Q4 and 1999 Q1 shallower.

A18 Quarterly growth of household consumption expenditure (including non-profit institutions serving households) had been unchanged at 0.6% in Q3. However, revisions to previous quarters back to 1998 Q1 had reduced the level of consumption in Q3 by 0.6%. Much of the downward revision in 1999 Q1 and Q2 had reflected changes in the seasonal pattern of expenditure on cars (which had been significantly affected by the introduction of the new registration month in March 1999). Quarterly growth in investment in Q3 had been revised down by 0.1 percentage points to 0.1%, but upward revisions to previous quarters, mainly to investment by the 'other services' sector, had increased the level of investment in Q3. Growth in investment in the services sector had slowed during 1999, and manufacturing investment continued to fall in Q3. Government consumption expenditure growth had been revised upwards to 0.7% in Q3, but downward revisions to previous quarters had left the level 0.3% lower.

A19 Final domestic demand in Q3 had been slightly weaker than domestic demand growth because the change in inventories (revised up slightly) had contributed 0.1 percentage points to quarterly GDP growth. Revisions to previous quarters reduced the amount of destocking in 1998. Excluding the alignment adjustment, inventories had risen by £230 million in Q3. The revisions made little difference to the pattern of inventories as a proportion of output.

A20 The deficit on trade in goods and services had narrowed in Q3 to £2.9 billion. Revisions to 1998 data had reduced the overall current account balance for the year to a £0.5 billion deficit from a surplus of £0.1 billion. Both import and export volumes growth had been strong in Q3 at 4.5% and 6.0% respectively. Monthly goods data had shown that export volumes had fallen 2.4% in October, while import volumes had remained high. Exports to non-EU countries had bounced back slightly in November.

A21 Within the household sector, real post tax income had fallen by 2.0% in Q3, but there had been considerable volatility in recent quarters reflecting sharp changes in dividend income. The household saving ratio had fallen to 4.5% as a result of the fall in income. Growth in the gross operating surplus of corporations had been revised up in Q3 to 3.5%. The level of the gross operating surplus in Q3 had been revised up by 5.7%. Net borrowing by PNFCs had increased as a percentage of GDP in Q3 compared with a year ago.



A22 Retail sales volume growth had increased by 0.2% in November, following an upwardly-revised 0.8% rise in October. The three-month on three-month growth rate had continued to slow. The CBI distributive trades survey had shown a positive net balance of 41% of retailers reporting increased sales volumes in December, and a balance of 21% expecting volumes to rise in January. Consumer confidence remained high: the GfK measure rose by 3 points to a net balance of +1.7 in December. Figures from the Society of Motor Manufacturers and Traders had shown total new car registrations in December 12.2% up on a year ago, although this comparison had been affected by the new registration month. Registrations for the whole of 1999 had been 2.2% lower than in 1998.

A23 The Nationwide measure of annual house price inflation had remained unchanged in December at 13.3%. The Halifax measure had increased to 13.6%, the highest annual growth rate since August 1989. The monthly growth rate of the Halifax index had been 2.6% in December, but this followed a fall in November. Housing transactions, measured by the number of particulars delivered, had increased in December, but remained well below the levels seen in the late 1980s. Data from the Royal Institute of Chartered Surveyors had shown a fall in the seasonally-adjusted net balance of estate agents reporting price rises in the three months to December. The sales balance had indicated a fall in the number of transactions.

A24 Data on economic activity in the fourth quarter of 1999 had remained strong in general. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing activity index had increased to 56.1 in December, from 54.7 in the previous month, although the output balance had been broadly flat over the last six months. The CBI monthly industrial trends survey showed a slight strengthening of orders and output expectations. The CIPS construction index rose to 58.2 in December, and although the CIPS services index had fallen to 58.3 in December it continued to indicate growth.

#### **IV The labour market**

A25 Employment growth had been more subdued than it had seemed from the previous two months' data. LFS employment had increased by 66,000 (0.2%) in the three months to October compared to the previous three months. Workforce jobs had fallen by 48,000 during Q3. Both the slower LFS employment growth (by comparison with previous, overlapping, LFS data) and the decline in workforce jobs had been driven by a large fall in self-employment. Workforce jobs, however, were generally more

volatile than LFS employment. Most of the increase in LFS employment had been in full-time employment, which rose by 62,000 (0.3%). Part-time employment had risen by 4,000 (0.1%). As a result, employment growth in full-time equivalent terms had also increased. Total hours worked had fallen by 0.3% in the three months to October compared with the previous three months, and average hours had fallen.

A26 Workforce jobs had been revised following the annual benchmarking exercise to make the data consistent with the most recent Annual Employment Survey. The impact of these revisions on the data, however, had been relatively small. Annual productivity growth, calculated using workforce jobs, had increased 0.5 percentage points in Q3, to 1.2%.

A27 Survey data confirmed the weaker picture on employment growth. The CIPS manufacturing survey in December had shown manufacturing employment falling again, after two months of stability. In the CIPS services and construction surveys employment had continued to grow, but more slowly than in recent months. The Manpower survey for Q4 had indicated a slowdown in employment growth in all sectors.

A28 Despite the weaker employment growth, skill shortages persisted. The Recruitment and Employment Confederation (REC) survey in December had shown that shortages of agency staff had increased again. Similarly, the Bank's Agents had reported that skills shortages persisted and, in some areas, had worsened. New vacancies reported to jobcentres had also fallen in November, while outflows (including placings) had risen, although both flows were volatile.

A29 Unemployment had continued to fall on both the LFS and claimant count measures. LFS unemployment had fallen by 12,000 and the unemployment rate by 0.1 percentage point in the three months to October compared to the previous three months. Claimant count unemployment had fallen by 10,600 in November from the previous month. Short-term LFS unemployment had fallen a little, while long-term unemployment had risen. Dispersion of unemployment rates across regions had declined slightly in Q3. However, dispersion of unemployment rates at the county and travel-to-work area level suggested that regional data may understate the increase in dispersion in recent years.

A30 Inactivity had fallen by 17,000 during this period compared to the previous three months, due mainly to a decline in the number of people who wanted a job, but were either not seeking or not available to start. This reversed the pattern of the previous two quarters.

A31 Earnings growth had increased in most sectors. Whole-economy headline earnings growth had risen 0.2 percentage points to 4.9% in the year to October. Headline earnings growth in the private sector had risen 0.3 percentage points to 5.1%, while public sector growth had been unchanged at 3.9%. Earnings growth in both manufacturing and services was also higher. However, the Reward index had again grown by only 3.5% in November.

A32 Wages and salaries per head, calculated from the National Accounts, had grown by 4.7% in Q3, the same rate as the Average Earnings Index. Following revisions, growth in unit wage costs had been falling since a peak in 1998 Q4. The FRES/REC survey had indicated that earnings growth for permanent staff supplied by agencies had remained broadly flat in December, while earnings growth for temporary/contract staff had fallen slightly.

A33 There was little new information on settlements, as was typical of this time of year. The Bank's AEI-weighted twelve-month mean had fallen 0.1 percentage point to 3.4% in November. Public sector and private sector settlement means had both fallen slightly.

## **V Prices**

A34 Commodity prices had risen in the last month. The Bank oil-inclusive commodity price index had risen by 2.9% in November, more than recovering the fall in October, and taking the annual inflation rate to 16.8%, its highest since this series began in 1990. Most of the increase was accounted for by the rise in the price of crude oil. While the prices of 'hard' commodities (fuels and metals) had been rising month-on-month for some time, the prices of 'soft' commodities (mainly food) also rose in November. This meant that the Bank oil-exclusive index, which had been broadly flat since the end of 1998, had also risen in November. Oil prices rose only slightly in December but were around 150% higher than a year earlier. There was no evidence to suggest that these price rises were linked to pre-millennium stockpiling, as inventories did not appear to be abnormally high.

A35 Manufacturing input prices had risen by 1.7% in November, in part reflecting higher oil prices, taking the annual inflation rate to 9.1% - its highest since September 1995. The CIPS input price index had fallen slightly in December.

A36 There had been a slight pick-up in output price inflation (PPIY), largely reflecting higher prices of petroleum products. The CBI output price expectation balance, however, had remained well below its long-run average.

A37 There had been significant revisions to the National Accounts deflators. The GDP deflator had risen by 2.4% in the year to 1999 Q3, revised up from 1.8%. This mainly reflected upward revisions to both the government and consumers' expenditure deflators since the start of 1998. The consumers' expenditure deflator had risen by 2.4% in the year to Q3, revised up from 1.8%; on the revised data, inflation on this measure eased between Q2 and Q3, in line with RPIX inflation. The retail sales deflator had risen by 0.2% in November, the first rise in 9 months, leading to a slight fall in the annual rate of deflation.

A38 RPIX inflation was 2.2% in November, unchanged from October. RPIX service price inflation had remained at 3.9%, while RPIX goods price inflation had picked up slightly to 0.5%.

## **VI Reports by the Bank's regional Agents**

A39 The Bank's regional Agents reported a continued moderate recovery in manufacturing activity, although volume growth had been stronger than value growth in many cases. There had been little evidence of capacity constraints in manufacturing firms. Service sector output growth had stabilised at a high rate. IT-related activity had been flat approaching the year-end but it was expected to resume strongly in the New Year. There had been some evidence of increased capacity constraints in the service sector, mostly as a result of skill shortages. Construction activity had remained strong overall, but with wide regional variations.

A40 Agents reported an improvement in retailers' year-on-year sales growth in December, with early indications that there had been solid Christmas trading. New car sales had been broadly flat and the used car market had also remained weak.

A41 Manufacturers had continued to find it difficult to pass on increases in input prices, and margins had been squeezed further. In the service sector, input price increases remained easier to pass through to consumers. There had been further downward pressure on retail goods prices, particularly food, clothing and electrical goods. Manufacturing pay settlements in early 2000 were expected to be no higher than a year earlier. But stronger pressure had been seen in the service sector, mostly reflecting skill shortages. City bonuses were expected to be much higher than last year.

## **VII Market intelligence**

A42 Market expectations of official UK interest rates implied by short sterling futures contracts had risen since the previous meeting of the Committee; most of this movement had occurred in early January. A large majority of market participants expected the Committee to increase official interest rates by 25 basis points at its next meeting; a few predicted a 50 basis point rise. Interest rate expectations had also risen sharply in the US and euro area, with futures contracts implying that interest rates in each would be increased by a total of 50 basis points in the first quarter of 2000. The smooth transition to the Year 2000 had reinforced expectations of rate rises, particularly in the US. Data releases in the UK, US, and euro area had been interpreted as signalling stronger global economic prospects.

A43 Sterling had appreciated against the dollar during the month. It had risen less against the euro, although in late December sterling had reached a new high against the euro. Some market participants had commented that they expected the euro to appreciate over the next year. Data releases indicated that the German economy was recovering, and structural reforms in the euro area were in prospect. On balance, market forecasts for 2000 were for the sterling-dollar exchange rate to remain broadly stable, and for the euro to appreciate against both sterling and the dollar.