

Publication date: 19 July 2000

---

---

# MINUTES OF MONETARY POLICY COMMITTEE MEETING 5 and 6 July 2000

---

---

These are the minutes of the Monetary Policy Committee meeting held on 5 and 6 July 2000.

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0007.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 2 and 3 August will be published on 16 August 2000.



## **MINUTES OF MONETARY POLICY COMMITTEE MEETING HELD ON 5-6 JULY 2000**

1 Before turning to its immediate policy decision, the Committee discussed demand and output; the labour market; monetary and financial conditions; the world economy; prices and costs; and any tactical considerations relevant to its decision.

### **Demand and output**

2 In the latest National Accounts, the level of real GDP at market prices had been revised up by 0.6% in 2000 Q1, with the GDP deflator lowered by almost as much. The revisions principally reflected higher figures for household consumption, following the Annual Retailing Inquiry. Most of the changes had been to growth in 1998; indeed real GDP in 1998 Q4 was now 0.8% higher than earlier estimated. The recent revisions showed quarterly growth peaking in 1999 Q3. The slowdown since then had been marginally more rapid than on the earlier data, but might not continue in Q2.

3 Upwards revisions to the level of GDP might imply greater pressure on capacity in the economy. However, since most of the changes dated back to 1998, and in the absence of other indications of such pressure, it was also possible that the economy's capacity for non-inflationary growth was higher than previously believed, or that the short-run trade-off between output and inflation was more favourable than indicated by previous data. In practice it was difficult to distinguish between these hypotheses. In accounting terms, measured productivity had improved in line with the increase in estimated output, with the rather puzzling slowdown a couple of years ago now less apparent. Whether this suggested any improvement in trend productivity growth which could be extrapolated into the future was unclear.

4 Estimates for GDP growth in 2000 Q1 were unchanged, at 0.5% on the quarter, with final domestic demand now thought to have grown by only 0.1%, or by 2.8% on a year earlier, compared with 4.6% in the year to 1999 Q4. Quarterly growth in household consumption was still put at 0.6% in Q1, having been revised up in the previous quarter from 1.1% to 1.5%. The household saving ratio, at 3.8% in Q1, was now at its lowest level since 1988 Q3. Investment had been revised down sharply, to show a fall of more than 1% in Q1. The latest figures for net trade continued to suggest a

positive contribution to growth in Q1, despite the strength of the exchange rate, while government consumption was now estimated to have fallen by 0.6%.

5 The fallback in investment was puzzling, although investment was an inherently volatile series, representing as it did the rate of change in the capital stock. Government and business investment had both fallen in Q1, in particular in transport equipment, although manufacturing investment had risen somewhat for the second quarter in succession after a long period of decline. It was possible that the path of business investment in recent quarters had been influenced by a clustering of projects ahead of the new millennium. On the one hand, the share of investment in GDP had been abnormally high and might revert to more normal levels, especially given the continuing squeeze on margins and low profitability in some sectors. On the other hand, it was noted that the high share of investment might persist if, for example, the relative price of some capital goods – for instance information technology – continued to fall.

6 Stockbuilding had been rather faster than expected in 2000 Q1, but the National Accounts estimates suggested it had fallen in manufacturing, in contrast to the results of a survey by the Bank's regional Agents. The picture was therefore confused, but in any case stockbuilding was a volatile series which was particularly prone to revision. In Q1 it also included a large (and negative) alignment adjustment, and it would be unwise to put too much weight on the data yet.

7 The net trade picture remained puzzling, although export volume growth appeared to reflect the strength of demand in overseas markets. On the basis of data currently available, however, net trade seemed unlikely to make a positive contribution to GDP growth in 2000 Q2.

8 Preliminary indicators for final domestic demand in Q2 suggested rather moderate growth, if not as low as in the previous quarter. Retail sales volumes in May had risen by less than expected and were now 3½% up on a year earlier, compared with 6.3% in January, when the pattern of spending might have been distorted by millennium-related effects. The CBI Distributive Trades Survey showed the balance on retail sales volumes falling from +45 in May to +15 in June, which was below its long-run average for the first time since October 1999. Consumer confidence, as measured by the GfK survey, had also fallen back, although this might well reflect seasonal factors.

9 Recent movement in asset prices might also lead to some moderation in consumption growth. In particular, most indices of house prices had decelerated by more than had been expected, with little if any increase in prices reported in the most recent months. The preliminary survey balance for house prices produced by the Royal Institute of Chartered Surveyors (RICS) had fallen, on the basis of a 90% sample, from +26 in May to single figures in June, having been at +61 as recently as March. There were some signs that housing activity might be slowing, with the House Builders' Federation reporting that net reservations and site visits had fallen in May, in the latter case to the lowest level since August 1995.

10 Survey data for manufacturing output suggested a further slowing in growth. The Chartered Institute of Purchasing and Supply (CIPS) survey had fallen to just above the 'no change' 50 level, and the output expectations balance was slightly lower in the June CBI survey. The Engineering Employers' Federation had reported a sharp fall in its output survey, with signs that growth was slowing in parts of the 'new' economy. Nevertheless, manufacturing and industrial production data from the Office for National Statistics had been stronger than expected in May, with manufacturing output up 0.4% on the month, and with energy output falling less than expected after April's strong rise. Both series were around 2% higher than a year earlier, despite sterling's strength over that period.

11 There were some signs that growth might be moderating elsewhere in the economy, with the business activity index in the CIPS services survey having fallen, as had the CIPS new orders index for construction, although both remained well above the 50 level. The CBI/PriceWaterhouseCoopers measure of optimism in financial services was down sharply, from +36 in March to -6 in June. There were also reports from the Bank's regional Agents of a slowdown in business travel and road haulage, although financial services, IT and telecommunications remained robust.

12 Public spending seemed likely to support growth over the medium term. The Treasury representative said that the government's three-year spending review would be concluded later in July, and the Committee would be briefed in detail on its contents ahead of its August meeting. At this point it was clear that current spending would grow within the 2½% envelope, and capital spending would rise to 1.8% of GDP as announced in the Budget. There would be a switch away from Annually Managed Expenditure (reflecting lower unemployment and debt interest payments, as a result of lower market interest rates and the decision to use the mobile phone spectrum auction

proceeds to reduce debt) and towards spending subject to Departmental Expenditure Limits. It was unclear how quickly, and to what extent, departmental underspends from earlier years would be reversed, which would slightly change the path of total spending within the Budget envelope.

13 The Committee agreed that some slowing in domestic demand growth had been required; earlier rates had been unsustainable, especially since net trade could not continue to act as a drag on GDP growth for the indefinite future. Prospects for external demand now seemed rather stronger than they had at the time of the May *Inflation Report*, following the fall in sterling, and so the question was whether domestic demand growth would fall back faster than had been assumed in the *Report*. To date, the evidence of a slowdown in the underlying growth of consumption appeared more compelling than for investment, where the Q1 data might have been erratic.

### **The labour market**

14 The Committee discussed the recent surprisingly benign labour market data. According to the Labour Force Survey (LFS), employment had increased by around 110,000 in the three months to April compared with the previous three months (although the increase was less in full-time equivalent terms, at around 60,000). Over the same period, LFS unemployment had fallen by 0.2 percentage points to 5.7%; the claimant count measure was also lower. But despite this evidence of an apparently tightening labour market, the Average Earnings Index (AEI) showed earnings growth falling sharply, from 5.7% to 5.1% on the three-month 'headline' basis, and from 5.2% in the year to March to 4.4% in the year to April.

15 Much of the rise in employment was reflected in a reduction in the numbers of the long-term unemployed and a decline in the inactivity rate. Since 1995 short-term unemployment rates had fallen from around 5% to 4%, while long-run unemployment had declined from nearly 4% to around 1½%. This might suggest that the various labour market reforms over this period had increased the supply of those available for work, allowing rather faster employment growth for any given rate of wage inflation. If this pool of labour should become depleted, however, and the short-run unemployment rate dropped steeply, there might be increased pressure on earnings growth. More generally, although changes in employment tended to lag changes in output, the present strength of employment did not suggest that employers expected a sharp slowdown in the economy.

16 Not all of the quantity indicators for the labour market pointed in the same direction. The Workforce Jobs measure of employment had fallen in Q1, but this was a more volatile series, and was based on a single day's sample. Total hours worked had risen in April, but over the past two years average hours worked had fallen by around 2% for those in full-time employment, pushing up estimates of the growth in productivity and pay per hour relative to the 'per head' measures.

17 The Bank's regional Agents reported little change in skill shortages over the past month, although these remained a concern to many employers. The Recruitment and Employment Confederation suggested that these shortages had intensified in June, but the NatWest SBRT quarterly Small Business Survey indicated an easing over the past two quarters, albeit from rather high levels, and other surveys suggested a largely unchanged picture.

18 The AEI data showed an unexpectedly sharp slowing in earnings growth in April. In part this was due to bonus payments, which had reduced earnings by 0.2 percentage points in the year to April, but growth in regular pay had also slowed, from 5.1% in the year to February to 4.4% in April. The most recent data were consistent with the view that the pick-up in earnings around the end of the year might have been even more influenced by bonuses and millennium-related payments than had been thought at the time. The Committee had noted at its previous meetings that the rise in earnings around the year-end might well reflect temporary factors, and therefore needed to be treated with caution; so too did the latest figures. While there seemed to be some news in the recent data, which were lower than assumed in the *May Inflation Report* for 2000 Q1, and in all likelihood for Q2, the *Report* had assumed that earnings growth would fall back quickly and have little impact on inflation two years out. Looking back over the past two years, there now appeared to have been two peaks in earnings growth which had since been reversed, giving a rather flatter picture for underlying earnings growth than the steady increase seen from 1995 to 1998.

19 As usual, there were relatively few new pay settlements in May. There continued to be reports that the pay round this year might be more difficult with RPIX and, more particularly, RPI increasing more rapidly than last year, and the labour market remaining tight. But as yet there was little evidence of this in the twelve-month numbers, although on a three-month basis settlements were no longer below 3%.

20 Productivity growth per head based on the Workforce Jobs numbers was now somewhat above its previous trend, at 2.2%, with unit labour costs growing at just below 3%. But using LFS employment figures, growth in productivity per head was lower, at 1.7%. The share of labour in national income had continued to rise, although this seemed to be flattening off a little and had not yet reached its early 1990s peak.

### **Monetary and financial conditions**

21 Notes and coin had grown by 7½% in the year to June, with growth now clearly below the underlying 8-9% range seen since November 1999. The three-month annualised rate was a little lower, at just below 7%. Such a slowdown in narrow money growth could be consistent with a moderation in nominal retail sales growth.

22 A rather different picture emerged from the figures for M4 lending. While household M4 had been weak in May, M4 lending to households had continued to grow by around 10% on a year earlier. Growth in both secured and unsecured borrowing had increased, with the number of mortgage approvals also higher over the month. As a result of the new set of National Accounts, estimates of mortgage equity withdrawal had been revised up to £2.3 billion in Q1, but total lending for consumption, which included unsecured lending as well as mortgage equity withdrawal, had nevertheless slowed since the second half of 1999.

23 Although there had been no further acceleration in household borrowing over the past few months, its continuing strength raised doubts about the extent of the slowdown in consumption. The financial balance for households was now in deficit, and at its lowest levels since the late 1980s; gearing measures were, however, rather low, with income gearing reflecting relatively low interest rates and capital gearing the sharp increase in wealth in recent years. While household borrowing might increase if the economy slowed suddenly, this would usually be in response to higher unemployment; 'distress borrowing' of this type did not seem to be significant at present. It was possible that some borrowing might have been on the basis of expected increases in wealth, either in equities or (more especially) housing, which might not now materialise; surveys on house prices and housing market activity increasingly suggested that the peak in growth had now passed.

24 The Committee noted that since February, when it had last raised the repo rate, fixed-rate yields had fallen by around 50 basis points at five years, although longer yields, particularly on corporate paper, had moved by less. Similarly, while the repo rate had increased by 100 basis points since last August, rates on retail borrowing and deposits had typically risen much less. For mortgages, however, the standard variable rate had risen by almost as much as the repo rate.

25 M4 lending to the private non-financial sector had also picked up in May, although much of this was to finance mobile phone spectrum auction payments. Some members noted that part of the borrowing might reflect pressures within the corporate sector, with evidence of greater dispersion than usual in company profitability and capital gearing, as set out in the June issue of the Bank's *Financial Stability Review*. The numbers needed to be looked at carefully; for instance where intangible assets were important, capital gearing measured on a market-value basis might be very different from that on a replacement-cost measure. To the extent that the differences in profitability reflected greater competition, and resources from less successful companies were absorbed by those which were more successful, the macroeconomic effects over the medium term should not be damaging. But over the shorter term there was a risk of greater fragility than was apparent from data for the corporate sector as a whole. While there was little sign yet of widespread corporate distress, the combination of heavy borrowing with low investment in the aggregate figures remained a puzzle.

26 Sterling's exchange rate index had moved very little over the past month after its sharp fall in May, which had taken it back to its levels of early November 1999. Sterling remained relatively strong against the euro, but by recent standards was rather weak against the dollar. The exchange rate index – at around 105 – was now close to its average over the past three years, but remained well above the levels of 1993-96.

27 Implied interest rates from forward curves suggested that the market expected higher official rates in the euro area, the United States and Japan later in 2000. Official rates were now lower in the United Kingdom than the United States; this had not been the case for any length of time since 1984. If rate expectations overseas changed vis-à-vis the United Kingdom, this might lead to further movements in sterling. It was also possible that a sharp move in the euro against the dollar would itself influence sterling's exchange rate index, with the size of the effect depending on how far sterling followed the dollar as opposed to the euro, and on the relative weightings of the dollar and the euro in the index.

28 The Committee noted that sterling's exchange rate index was based on trade in manufactures, and that the euro had a weight in it four times that of the dollar. To some, this seemed somewhat overstated. Much of UK trade which was not invoiced in sterling was invoiced in dollars, and this might have some effect on import prices, if only in the short term. Earlier work by Bank staff had suggested that altering the weights to take account, for instance, of trade in services did not make a great difference to the index. The Committee agreed to look at these calculations again in the coming months.

29 The impact of the lower exchange rate on RPIX depended in part on how much of the earlier appreciation had fed through into import and retail prices, and on how far this differed from the assumptions made in the *May Inflation Report*. To the extent that the market had correctly anticipated that the earlier rise in the exchange rate would be reversed rapidly, the feedthrough into prices might be less than otherwise. That said, non-oil commodity prices had risen sharply in sterling terms in May.

### **The international environment**

30 There was some evidence that the US economy was beginning to slow, on the basis of the non-farm payrolls data, retail sales and industrial confidence, as measured by the National Association of Purchasing Managers. Such a slowdown had long been expected, but growth in the United States seemed likely to remain relatively robust by historical standards, with core CPI inflation so far remaining subdued. The recovery in the euro area also appeared to be on track, with private sector forecasters now expecting growth of around 3¼% this year, with the harmonised index of consumer prices rising by close to 2%.

31 In Japan the Tankan survey had been, if anything, a little stronger than expected, with much speculation about when the zero interest rate policy might end. While a change in monetary policy, in Japan as elsewhere, inevitably brought with it the risks that markets would extrapolate any move unduly and hence react in an exaggerated fashion, the move when it came was unlikely to be a surprise. In any case, the direct effects on the United Kingdom would probably not be large, and would depend on the reaction of the yen to any change in interest rates.

32 Among the emerging market economies there were signs that growth in industrial production had peaked, after a rapid recovery in several of these countries, but the level of output remained well above that of a year earlier.

### **Prices and costs**

33 The oil price had stayed higher for longer than assumed in the *May Inflation Report*, averaging around \$27 per barrel in 2000 Q2, as against just over \$23 per barrel assumed in May. To the extent that the proceeds from higher oil prices were not spent by the producers, or by governments which enjoyed higher oil-related tax revenues, this would reduce demand, in a similar way to an increase in indirect taxes.

34 The direct impact on RPIX was more obvious, with higher petrol prices contributing 0.5 percentage points to the annual inflation rate in May. While the outlook for oil prices remained uncertain, it was possible that recent announcements of increased production would lead to a fall in prices, although perhaps not to the levels assumed in the *May Inflation Report*.

35 To the extent that higher oil prices had already fed through into retail prices, or would do so shortly, the effect might be to raise the short-term profile of RPIX inflation closer to target, while reducing pressure on prices further ahead. This might be more likely if the rise in oil prices indeed proved short-lived, although it was possible that there would nevertheless be second-round effects from higher oil prices, in which case the effects would be less benign.

36 RPIX had risen by 2.0% in the year to May. This included upwards effects from higher oil prices and house price inflation, and dampening effects from lower utilities prices and the exchange rate. Some members noted that some measures of core inflation were below actual inflation, suggesting that inflation would fall for a time. For example, the twelve-month change in RPIX excluding food, drink, tobacco, petroleum and other energy products had now fallen to 1.7%. But it was unclear how much information about the prospects for inflation could be gleaned from such a disaggregation; the aggregate price level should not be affected in the medium term by relative shifts in its components.

37 There was some evidence from the CBI Distributive Trades survey that downward pressures on retail prices had intensified, with the balance in 2000 Q2 at -6, as against +18 in 1999 Q2. By contrast, surveys of manufacturing and services prices by the British Chambers of Commerce suggested that output price pressures were much stronger in 2000 Q1 than in 1999 Q2. It remained to be seen whether this pressure on margins would be sustained.

38 As a result of higher oil prices and a weaker exchange rate, the Committee agreed that inflation over the rest of this year might move closer to the 2½% target than had seemed likely at the time of the May *Inflation Report*. If inflation over the medium term were likely to be above its target, rather higher inflation now might mean that the Committee had less time to wait before it needed to raise rates. But it was unclear whether the risks to inflation over the medium term were on the upside, or indeed whether higher-than-expected retail prices in the short term had significant implications for inflation further ahead.

### **Tactical considerations**

39 The Committee noted that there was very little expectation in the market of a change in the repo rate this month, and that neither the FOMC nor the European Central Bank was expected to move rates in the immediate future. Against that background, there was a risk that any change in UK rates would lead to a larger movement in interest rate expectations than would be warranted, with a corresponding effect on the exchange rate. While this might be a reason for leaving rates at 6%, it did not of itself preclude a change in rates this month if there were good reasons to move in terms of the outlook for inflation. As always, if rates were to be changed unexpectedly, it would be necessary to set out clearly the reasons for the Committee's decision.

40 The Committee agreed that it was difficult to calibrate the effects of the recent slowdown in domestic demand on inflation prospects over the medium term. By comparison some felt that the effects of the weaker exchange rate and lower-than-expected average earnings would be easier to calibrate, although even in these cases it would be necessary to re-examine some of the assumptions made about the pass-through into prices over the medium term. The forthcoming forecast round provided an opportunity to assess the relative impacts of these developments in some detail, and the August *Inflation Report* a means of explaining how this analysis had influenced the views of the Committee.

### **The immediate policy decision**

41 The Committee agreed that the news on the month was weaker than expected, with signs of a slowdown in domestic demand, for instance in retail sales and the housing market, and lower-than-expected, although possibly erratic, average earnings numbers. The question for some was rather whether the news in the two months since the *May Inflation Report* warranted an increase in interest rates to keep prospective inflation in line with the target over the medium term.

42 Various arguments were advanced by members for leaving the repo rate unchanged at 6% this month. Many of the determinants of consumption (such as house prices and earnings) appeared to be slowing, while the buoyant borrowing figures for households and corporates, although they needed to be watched carefully, might not in the short run be a reliable guide to consumption or investment. Upwards revisions to the level of GDP, for a given rate of inflation, suggested to some members that the disinflationary forces in the economy might be rather greater than previously supposed. The slowdown in the housing market appeared broadly based, being reflected not just in the house price indices, but also in the more forward-looking RICS survey and in measures of activity at the start of the housing chain, such as site visits and net reservations. The average earnings figures were much lower than expected, even allowing for the erratic nature of the series, with little sign yet of much of an increase in pay settlements during a period in which they had been expected to come under upward pressure.

43 So far as external influences were concerned, if oil prices fell from their recent peaks, this would, other things being equal, reduce inflation in the short term. The fall in the exchange rate since May would tend to increase inflation, but to the extent that it represented a rather rapid reversal of a short-run spike it might have less of an effect, while the long-term negative impact on investment decisions of sterling's appreciation since 1996 may not yet have been fully felt. It also appeared to some that the current monetary policy stance was slightly contractionary and that this might no longer be appropriate; with nominal rates at 6%, given most current measures of inflationary expectations, real interest rates were 3½% or more. With little expectation of an immediate move in rates either here or in the UK's major trading partners, it was best to leave the repo rate unchanged at 6% this month.

44 For some other members, given the news since May, while there was no need to raise the repo rate this month, it might be necessary to raise rates later to keep prospective inflation on track. While there was some evidence of a slowdown in the growth of domestic demand and average earnings, the latter series remained erratic. Little weight had been placed on the acceleration in the AEI in previous months, and little should be placed on its deceleration; the labour market remained tight and, if anything, pay settlements were creeping up. The fall in investment was puzzling, especially given heavy borrowing by the corporate sector, and might prove temporary. Borrowing by households remained strong, which did not seem consistent with a sharp fall in consumption; nor did the recent pick-up in the growth of employment. Much of the apparent slowdown in domestic demand might represent an unwinding of end-year effects, which now appeared to have boosted retail sales, average earnings and investment, if only temporarily, by more than had previously been thought. Looking forward, given the likely increases in public spending over the next two years, private sector spending needed to slow further if the inflation target were to be met.

45 The exchange rate had not fallen any further over the past month, but was 5% lower than in the *Inflation Report*. This provided some much-needed relief for the externally-exposed sectors, and with it the prospect of a better-balanced economy but, taken by itself, it added to pressures on inflation in the medium term. As a result, for these members it was important that measures of domestic inflationary pressures fell back from their present levels of around 3% for the inflation target to be met. While it now seemed rather more likely that domestic demand growth would slow, it was less clear that this would be by more than assumed in the May *Inflation Report*, as it needed to be given the improved prospects for net trade. The August *Inflation Report* provided an opportunity to assess the extent of the slowdown in domestic demand (and the weakness of consumption and investment in relation to their underlying determinants) and weigh this against the effects of higher oil prices and lower sterling. While the position might have been more comfortable if rates had been raised a little higher earlier it was now best to wait until August for more news, and analysis, in the context of the *Inflation Report*. For these members too, the repo rate should stay at 6% this month.

46 The Governor invited members to vote on the proposition that the Bank's repo rate be maintained at 6.0%. The Committee voted unanimously in favour of the proposition.

47 The Committee congratulated the Governor on his being made a Knight Grand Cross of the British Empire in the Birthday Honours List.

48 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

Christopher Allsopp

DeAnne Julius

Stephen Nickell

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 Bank staff to the Monetary Policy Committee on 30 June in advance of its meeting on 5-6 July 2000. At the start of the Committee 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 Evidence of a slowdown in US domestic demand growth remained inconclusive. Industrial production in May had risen by 0.4% on the previous month, and by 5.8% on a year earlier. But industrial confidence, as measured by the National Association of Purchasing Managers' index, had fallen to 51.8 in June from 53.2 in May. New house building permits had fallen by 9% in the year to May, and the Federal Reserve Senior Loan Officer Survey had indicated a tightening in lending standards. Consumer confidence had fallen, from 144.7 in May to 138.8 in June, but had remained at a historically high level. Real consumption had risen by 0.2% in the month to May, but nominal retail sales had fallen by 0.3% – the second consecutive monthly fall. GDP growth had slowed in Q2 in each of the two previous years. Some commentators had suggested that this might reflect an emerging seasonal effect from higher income tax payments. But an expenditure breakdown gave little support to this hypothesis. Private non-farm payrolls had fallen by 126,000 in May, but total payrolls had risen by 231,000, partly reflecting extra employment by the national census authorities. Annual consumer price inflation had been 3.1% in May.

A3 Euro-area GDP had increased by 0.7% in Q1, according to the first estimate. Consumption had been flat on the quarter, somewhat weaker than confidence surveys and the improving labour market might have suggested. Consumer confidence had fallen by two percentage points in June, though it remained high by historical standards, and industrial confidence had risen by four percentage points. Industrial production had risen by 0.7% in April. The unemployment rate had remained unchanged in May. Import and export trade volumes in the euro area had continued to increase strongly in Q1. HICP inflation had remained at 1.9% in May, and core inflation had not increased. Hourly nominal labour costs in Q1 had been 3.5% higher than a year earlier.

A4 Japanese GDP had increased by 2.4% in Q1, driven by net trade and private investment, after two consecutive quarters of negative growth. Corporate profits – a leading indicator of future investment – had risen by 38% on a year earlier. Retail sales had declined by 2.4% in the year to May, while employees' wages had risen by 0.5% in the same period. Consumer prices had declined by 0.7% in the year to May. The Tankan survey results had been better than expected, confirming that the corporate sector was healthy. Business conditions had continued to improve, though concerns had remained for some sectors, particularly small non-manufacturing firms.

A5 One-month and six-month Brent oil price futures had increased in June to an average of \$29.55 per barrel and \$26.33 per barrel respectively, from \$27.41 per barrel and \$25.12 per barrel in May. Stocks of oil and petroleum were lower than average.

A6 Since the previous MPC meeting the S&P 500 index had fallen by 0.6%, and the DJ Euro Stoxx index had fallen by 2.5%. By contrast, the Nikkei 225 had increased by 1.5% and the NASDAQ Composite had risen by 1.7%. Policy interest rates implied by futures contracts in the United States had decreased for July and August, but had risen for the period after October. Implied policy rates in the euro area had fallen.

## **II Monetary and financial conditions**

A7 The twelve-month growth rate of notes and coin had fallen from 7.9% in May to 7.5% in June. The three-month annualised rate had been lower still, at 6.9%.

A8 M4 had increased by £5.4 billion (0.7%) in May, raising the twelve-month growth rate to 5.0%. But the pick-up in growth had been mostly driven by other financial corporations (OFCs). Annual growth in M4 excluding OFCs had softened in May.

A9 By comparison, aggregate M4 lending (excluding the effects of securitisations) had been very strong in May, increasing by £15.4 billion (1.5%) on the month, and raising the twelve-month growth rate to 12.1%, its highest since February 1991. The rise had partly reflected strong borrowing by OFCs.

But borrowing by private non-financial corporations (PNFCs) had also risen further, and household borrowing had rebounded.

A10 Household M4 had been weak in May. Although recent outturns had been erratic, there were now fairly clear signs of slower growth since the start of the year in a range of household money measures, including notes and coin, retail M4, households' M4 and households' Divisia.

A11 M4 lending to households (excluding securitisations) had bounced back in May, though the annual growth rate had remained broadly stable at around 10%. Both secured lending and mortgage loan approvals had rebounded after a weaker April, perhaps reflecting the relatively low number of working days in April. Total unsecured lending had also been relatively strong in May, driven by a sharp rise in net credit card borrowing. But credit card borrowing could be volatile month to month, and other types of unsecured lending had been slightly weaker. A broader measure of total lending for consumption, which included mortgage equity withdrawal (MEW), was still estimated to have fallen in 2000 Q1 compared with the second half of 1999, though the Bank's staff estimate of Q1 MEW had been revised up, from £1.8 billion to £2.3 billion, following the National Accounts release.

A12 Total external finance raised by PNFCs had been strong again in May, increasing by £7.4 billion on the month. Some £4 billion of the £4.7 billion rise in bank borrowing had been publicly identified as reflecting finance for 3G licence payments. PNFCs' deposits had also risen in May by £2.5 billion, partly offsetting the impact of stronger gross borrowing on firms' net recourse to banks. The latest National Accounts had suggested that PNFCs' net financial deficit had been broadly unchanged in Q1, though strong subsequent borrowing might suggest a higher deficit in Q2.

A13 Annual growth rates of OFCs' M4 and M4 lending had risen in May, to 4.6% and 16.5% respectively.

A14 Since the previous MPC meeting, interest rate expectations, as measured by the two-week gilt repo curve, had fallen a little at the short end. Longer nominal interest rates had risen only slightly. The term structure of corporate yields had also flattened. Retail rates had been little changed in June, though two-year fixed-rate mortgage rates had returned to April levels after a small fall in May.

A15 One-year inflation expectations from the Consensus survey had risen from 2.2% in March to 2.4% in June. There had been a slight easing in survey-based real rates in the latest quarter, a period in which the official repo rate had remained fixed.

A16 The FTSE All-Share index had fallen by 1.7% since the previous MPC meeting, although the Small Cap index had risen by 3.1%. The IT sector and non-cyclical services (mainly telecommunications) had fallen by around 11% and 8% respectively over the same period.

A17 Since the previous MPC meeting, the sterling ERI had been little changed. Despite the depreciation in May, longer-term Consensus forecasts suggested that the expected value of the sterling ERI six years out had been little changed since February, though the expected sterling/dollar rate was now somewhat lower, and the sterling/euro rate somewhat higher, than before.

### **III Demand and output**

A18 The National Accounts, published on 29 June, had included revisions to GDP and its components, the cumulative impact of which had been to increase the estimated level of GDP at market prices in 2000 Q1 by 0.6%. Most of the upward revisions had been to 1998 growth, reflecting higher estimates of consumption as a result of the latest Annual Retailing Inquiry. Annual GDP growth in 1998 had been revised up to 2.6% from 2.2%, and the level of household consumption in 2000 Q1 had been revised up by 1.7%, reflecting the cumulative effect of revisions to growth rates in previous periods. GDP growth in 1999 had remained unchanged at 2.1%. Revisions to nominal GDP had been smaller than those for real GDP.

A19 Revisions to the income measure of GDP had been relatively small. Estimates of employees' compensation had been revised downward, particularly in 1998, while gross operating surpluses had been revised up. Due to the relatively larger upward revisions to nominal consumption, there had been a marked downward revision to the household sector saving ratio. Turning to the output measure of GDP, the level of manufacturing output had been revised up in 1998 by 0.2%, and the level of services output had been revised up by 0.5%. But there had been very little change to the pattern of growth through

1999. The unusually large discrepancy between the output and expenditure measures of GDP in 2000 Q1, seen in the earlier estimate, had been revised down.

A20 Estimated GDP growth in 2000 Q1 had been unrevised at 0.5%. The overall pattern of expenditure in recent quarters had remained broadly intact, although domestic demand had been revised down slightly in Q1, from 0.4% to 0.2%. Final domestic demand growth had also been revised down, and was now shown to have been broadly flat between Q4 and Q1. Household consumption growth had remained unchanged in Q1 at 0.6%, but growth in investment and government consumption had both been revised downward. The new government consumption profile was also flatter through 1999. The contribution to GDP growth from net trade in Q1 had been fractionally weaker than previously estimated, while that from stockbuilding had been slightly stronger.

A21 Turning to indicators of Q2 activity, overall industrial production had increased by 0.1% in May. Manufacturing output had risen by 0.4%, but had been mostly offset by a decline in energy output, which had unwound following particularly strong growth in April. But recent survey evidence had suggested a continuation of weaker manufacturing output in coming months. The manufacturing output expectations balance in the Confederation of British Industry (CBI) Monthly Trends survey had fallen slightly further, to -7 in June from -6 in May. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey output index had fallen to 50.5 in June from 50.9 in May, and the June Engineering Employers' Federation (EEF) manufacturing output balance had fallen to -2, from +8 in March.

A22 In the services sector, retail sales volumes had risen by 0.4% in May, but annual growth had slowed considerably, to 3.6% from 4.7%. Looking ahead, the CBI Distributive Trades survey had shown a considerable slowing in reported annual retail sales growth in June, with the total balance falling to +15, from +45 in May. The GfK confidence index had eased to +0.1 in June from +2.7 in May. Private new car registrations in the three months to May had fallen by 2.1% on a year earlier, while total new registrations had increased by 4.8%. There had also been some indications of slowing activity in other areas of the services sector. The CBI/PriceWaterhouseCoopers financial services optimism balance had fallen to -6 in June, from +36 in March.

A23 Earlier evidence of a slowdown in house price inflation had been confirmed. Although the Nationwide price index had risen by 0.4% in June, annual growth had continued to ease to 15.1%. Annual growth in the Halifax house price index had also slowed in June, to 9.2% from 11.2% in May. The Royal Institute of Chartered Surveyors (RICS) survey balance for house price inflation had fallen to +26 in May from +37 in April, and the House Builders' Federation (HBF) inflation balance had fallen from +33 to +21. Indicators of housing activity growth had also shown a further slowdown. The HBF site visits and net reservations balances had fallen in May – site visits to their lowest level in almost five years.

#### **IV Labour market**

A24 According to the Labour Force Survey (LFS), there had been an increase in employment of 112,000 (0.4%) in the three months to April, following growth of 82,000 (0.3%) in the previous three months. The rise in the three months to April had been the largest since September 1998. Workforce Jobs – a more volatile series, sampled on a single day in each quarter – had fallen by 35,000 in Q1, largely accounted for by a decline in service sector jobs of 52,000. As in the previous two months, most of the increase in LFS employment had been in part-time employment, which had risen by 92,000 (1.3%). Full-time employment had grown by 20,000. As a result, although employment growth in full-time equivalent terms had picked up, it continued to be much slower than growth in the number of those employed.

A25 The strong growth in employment had contributed to the 0.3% rise in total hours worked in the three months to April. Average working hours had declined slightly, largely accounted for by lower average hours worked by people in second jobs.

A26 CIPS survey measures of employment growth had been little changed in June. The surveys had indicated that employment growth in construction and services had slowed slightly, while manufacturing employment had declined at a slightly faster rate than in previous months. The Recruitment and Employment Confederation (REC) survey had indicated that shortages of both temporary and permanent staff had intensified in June, but the Bank's regional Agents had reported little change in overall skill

shortages. The CBI/Deloitte & Touche Service Sector survey and the CBI/PriceWaterhouseCoopers Financial Services Survey had also suggested a largely unchanged picture.

A27 New vacancies notified to Jobcentres and Jobcentre placings had both fallen sharply in May. However, this had been affected by three closely spaced public holidays in the accounting period, as well as a change in the criteria for including a notified vacancy in the official figures. The underlying falls were probably much smaller.

A28 Unemployment had continued to fall on both the LFS and claimant count measures. LFS unemployment had fallen by 60,000, and the unemployment rate by 0.2 percentage points, in the three months to April compared with the previous three months. Claimant count unemployment had fallen by 8,600 in May from the previous month, leaving the rate unchanged at 3.9%. As in Q1, the fall in LFS unemployment had been largely accounted for by lower long-term unemployment. Dispersion of unemployment across regions had risen slightly in Q1, but county-level dispersion had continued to decline.

A29 Inactivity had fallen by 15,000 in the three months to April compared with the previous three months, reflecting a 24,000 decline in female inactivity. Male inactivity had risen by 8,000.

A30 Headline earnings growth, as measured by the Average Earnings Index (AEI), had declined sharply in most sectors. Whole-economy headline earnings growth had fallen by 0.6 percentage points in April to 5.1%, with the private sector accounting for all of this decrease (down by 0.8 percentage points to 5.3%). Within the private sector, headline earnings growth had fallen in both private services and manufacturing, to 5.6% and 4.3% respectively. Headline public sector earnings growth had risen by 0.1 percentage points to 4.3%.

A31 Actual earnings growth had declined by 0.8 percentage points to 4.4% in the twelve months to April. The private sector had accounted for all of this decrease (down by 0.8 percentage points to 4.4%): public sector earnings growth had risen by 0.9 percentage points to 4.7%. Growth in regular pay, ie, excluding bonuses, had fallen to 4.4% in April from 4.7% in March (not seasonally adjusted). Bonuses had reduced earnings growth by 0.2 percentage points in April (not seasonally adjusted),

compared with a positive contribution of 0.9 percentage points in March. The Bank's estimate of growth in earnings per hour had also fallen back, to below 6% in April, with the increase in average hours narrowing the gap between heads and hours-based measures.

A32 The REC survey had indicated a pick-up in the rate of growth of permanent agency placement salaries in June. Growth rates for temporary staff had also increased.

A33 The growth of wages and salaries per head, calculated from the National Accounts, had increased slightly to 5.2% in Q1, broadly in line with the AEI over the period. But the growth rate of unit wage costs had fallen slightly, reflecting the offsetting influence of whole-economy productivity growth, which had been 2.2% in Q1. The broad trend of the labour share of national income had continued upwards, though it had yet to reach the early-1990s peak.

A34 As was usual for this time of the year, there had been little new information on settlements. The Bank's AEI-weighted twelve-month mean was flat at 3.1% in May. The public and private sector means were also unchanged.

## **V Prices**

A35 The Bank oil-inclusive commodity price index had risen by 6.4% in May, the second largest monthly rise since the start of the series in 1990. This had taken the annual inflation rate from 8.9% up to 16.4%. The increase had reflected large rises in the prices of all the components of the index except domestic food. The fuels component of the index had risen by 12%, largely accounted for by the rise of more than 20% in the sterling oil price in May. The sterling oil price had risen by a further 8% in June. The Bank oil-exclusive commodity price index had risen by 2.2% in May, and by 3.1% over the past year.

A36 Manufacturing input prices had risen by 3.6% in May, taking the annual inflation rate from 7.9% to 12.9%. The large monthly rise had mainly reflected the sharp increase in the price of oil in May, though there had also been rises in the prices of metals and of imported materials. Input prices excluding food, drink, tobacco and petroleum had risen by 0.7% in May, taking the annual rate of

inflation to 4.0%, its highest since November 1995. The CIPS manufacturing survey input price index had risen to 61.4 in June, up from 59.7 in the previous month. Output prices excluding excise duties (PPIY) had risen by 0.2% in May, taking the annual inflation rate to 1.7%, slightly up from 1.6% in April. The output price balance in the June CBI Industrial Trends survey had risen slightly, to -18 from -21 in May.

A37 The prices of imported and exported goods had risen by 0.4% and 0.8% respectively in the three months to April compared with the previous three months. Excluding oil, the price of imported goods had risen by 0.2%, while the price of exported goods had fallen by 0.1% over the same period.

A38 Annual inflation in the GDP deflator at market prices in 2000 Q1 had remained unrevised at 2.7%. But there had been revisions to the components. The annual inflation rates of the investment and government consumption deflators had been revised upwards in 2000 Q1, offset by downward revisions to the annual inflation rate of the household consumption deflator.

A39 RPIX inflation had risen to 2.0% in May, up from 1.9% in the previous month. This had largely reflected higher contributions from non-seasonal food prices, car prices and housing depreciation. RPI inflation had risen from 3.0% to 3.1% in May. RPIY inflation had risen to 1.7% in May from 1.6%, while HICP inflation had fallen from 0.6% to 0.5% in May. The difference between RPIX and HICP inflation had widened to 1.5 percentage points.

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

A40 The Bank's regional Agents had reported that growth in manufacturing output had eased further, although high-technology sectors remained strong. It was still too early for the depreciation of sterling to be seen in higher orders. Construction growth had slowed, mostly accounted for by weaker residential construction. There were signs that service sector growth had peaked. The financial services and IT sectors had remained strong, but business travel and in particular UK tourism, had been weaker. Agents' contacts had reported a more modest easing in annual retail sales growth than the official figures. New car sales were reported to be weaker after earlier stock clearances.

A41 The pass-through from the higher oil price to related products had been more evident recently. Downward pressure on manufacturers' domestic output prices had continued, although there were some signs of the fall in export prices easing and more firms were expecting to raise prices in the second half of the year. The recent depreciation of the exchange rate was not yet reported to have been passed through into retail prices. The level of house prices was reported to have peaked in some areas, though there was concern from some contacts that these levels remained too high. There had been little change in the profile of employment, and skill shortages had been broadly unchanged. Pay pressures in manufacturing had remained relatively muted but pressures in the service sector had strengthened.

A42 The Bank's regional Agents had conducted a survey of UK firms regarding stockbuilding in 2000 Q1. A net balance of about a fifth of firms reported that their stock levels had risen in Q1. At a sectoral level, the balance was highest in the manufacturing and motor trade industries. The majority of stockbuilding was reported to be voluntary across most sectors. Stocks in Q2 were expected to be broadly unchanged from Q1 levels.

## **VII Market intelligence**

A43 Market participants were not expecting a change in the Bank's repo rate at the July MPC meeting. Two-week forward rates going out to spring 2003 derived from the gilt market had fallen by up to 20 basis points since the June MPC meeting. Furthermore, short-term interest rate volatility had declined, perhaps reflecting increased market confidence about the level at which interest rates would peak. Expectations derived from the latest Reuters poll of private sector economists, together with rates implied by both short-sterling futures and overnight interest rate swaps, all suggested little expectation of a rise in interest rates in July. The expected peak in the Bank repo rate had fallen slightly over the month, to around 6¼%. More generally, market participants were waiting to see whether domestic demand growth had slowed, and if so, by how much.

A44 The sterling trade-weighted exchange rate had remained largely unchanged over the month. Implied correlations derived from options prices had suggested that a recoupling between sterling and dollar exchange rates had some way to go, and that sterling continued to be pulled by movements in both the dollar and the euro, with the effect on the trade-weighted exchange rate determined in part by

the greater weighting for the euro in the index. The rise in the euro:dollar exchange rate over the past two months had been greater than that predicted by the Consensus forecasts. The narrowing of interest rate differentials following the ECB's unexpected 50 basis point rate rise in June, and the continued economic recovery in the euro area, had both supported the euro. But other more technical factors, such as positioning and prospective flows relating to mergers and acquisitions activity and mobile phone spectrum auctions, had also helped the recovery in the euro over the past two months.