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MINUTES OF MONETARY POLICY COMMITTEE MEETING 6 and 7 June 2000

These are the minutes of the Monetary Policy Committee meeting held on 6 and 7 June 2000.

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0006.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 5 and 6 July will be published on 19 July 2000.



MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE HELD ON 6-7 JUNE 2000

1 Before turning to its immediate policy decision, the Committee discussed the world economic outlook; exchange rates; money and asset prices; demand and output; the labour market; prices and costs; tactical considerations; and the overall conjuncture. The Committee had also received a letter from the Chancellor (attached as an annex) setting out the inflation target at which the Committee should aim in accordance with section 12 of the Bank of England Act 1998.

The world economy

2 The latest estimates of growth in the euro area had been broadly in line with the Committee's forecast. In the United States, there had been a rise in consumer confidence in May. Non-farm payrolls had risen in May, although this may be a temporary effect because the rise was entirely accounted for by an increase in the number of those working on the national census. The unemployment rate had risen by 0.2 percentage points in May. There had also been a rise in equity prices over the past month. But the purchasing managers' index in April and the latest data on retail sales seemed to be a little weaker. Developments on prices and costs appeared more benign than in recent months. The reaction of some analysts, and in press reports, to the latest US data seemed quite marked and was perhaps a little surprising in the light of these mixed indicators. Commentators no longer expected a sharp rise in interest rates – and this could explain why equity prices had risen. But the latest indicators might be interpreted as suggesting that the US economy was returning to the previous pattern of strong demand growth and benign price pressures. The imbalances in the US economy – for example between domestic demand and net trade – remained, and so the question was still whether the economy would experience a 'soft' or 'hard' landing.

3 Since the previous meeting, the OECD had published its latest forecasts. These projections were for slightly stronger growth overall in the G7 compared with the December projections. The broad picture was for stronger growth in 2000 and slightly weaker growth in 2001 than the Committee had assumed in producing the May *Inflation Report* projections. But these differences were not particularly large. However, the latest OECD projections of slower growth in 2001 than in 2000 did

highlight the broader question of whether 2000 would prove to be the peak in world growth during the current cycle. Over the past six months there had been significant monetary policy tightening in a number of countries, and that might support a view that world growth would slow. Looking at financial market conditions more generally, there had been a rise in shorter-dated bond yields in many of the major industrial countries, although not the US, and equity prices had fallen somewhat since the peaks reached in the first quarter. Of course, it was possible that a rise in bond yields reflected market expectations of higher inflation, rather than a view that monetary authorities would tighten real interest rates more than previously thought. There were also signs that growth was slowing in various countries in Asia, and any further tightening by the US Federal Reserve was likely to have some effect on many developing economies, especially in Latin America.

4 The oil price had risen over the past month, but this did not seem primarily to reflect a stronger world demand picture. The Committee noted that there was an OPEC meeting towards the end of June. The rise in oil prices would put some upward pressure on UK inflation in the near term, relative to what had been assumed in preparing the *May Inflation Report* projections.

The exchange rate

5 The sterling effective exchange rate had fallen by around 5% compared with the profile assumed in the *May Inflation Report*, which used a 15 day average as its starting point. Since the time of the May meeting, there had been a larger fall of more than 7½%, reversing the rise in sterling over the previous six months. Apart from the period when sterling left the Exchange Rate Mechanism in 1992, it was the largest one-month change in the ERI since 1986. It was noted that the risks of a large or rapid depreciation in the exchange rate had been explicitly recognised, but not been built into the May fan chart projections.

6 Staff analysis suggested that the size of the depreciation over the month could not be accounted for by a change in interest rate differentials. The markets now expected no change in UK interest rates this month and there remained some expectation of interest rate increases in the euro area and in the United States. Looking along the yield curve as a whole however suggested that there was little monetary news over the month. It was possible that the decision not to raise interest rates in May would have lowered short-run interest rate expectations, but that this might have been masked because the large fall in sterling led to expectations of higher interest rates further out. Large

transactions related to mergers and acquisitions could have pushed sterling down at least temporarily on the day of the MPC decision, and the no change decision might have triggered further momentum-based sales, which might account for the size of the depreciation.

7 The Committee agreed that there could be no mechanical link between changes in the exchange rate and the decision on interest rates. The exchange rate change had to be taken into account, however, when assessing the prospects for inflation. Calibrating the magnitude of what appeared to be a real exchange rate depreciation on inflation over the next two years was difficult, just as it had been difficult to calibrate the effects of sterling's earlier appreciation. To the extent that the earlier rise in the exchange rate had not yet fed through to domestic prices, the recent fall might likewise have correspondingly less effect on prices.

8 In its May projections the Committee had taken into account the rise in the exchange rate and had assumed that the pass-through to retail prices would be somewhat slower than its historical average – although the eventual effect on the price level would be the same. There was great uncertainty about this, but applying the same procedure to the recent fall would on the face of it imply a rise in the inflation projection two years ahead on account of the exchange rate shift – of around half of a percentage point compared with the *May Report* projections. If the comparison was with the level of the exchange rate immediately prior to the Committee's May meeting rather than the 15 day average used in the forecast then the impact on future inflation would be correspondingly larger. However, these estimates were extremely sensitive to the assumptions made and it was possible that the effect on inflation would be smaller or larger than this. In particular it was suggested that, given the depreciation, the Committee might review the assumptions earlier made on overseas exporters' margins to the UK, and on retail margins in the UK. Some members thought that the recent depreciation was likely to have a smaller effect on prospective inflation, since overseas producers' margins to the UK might fall back faster than had previously been assumed. These issues would be reviewed in the August *Inflation Report* round.

Money and asset prices

9 Both the Halifax and Nationwide measures of house prices had fallen by 0.4% in May, and suggested that house price inflation was slowing at least as rapidly as had been assumed in the *Inflation Report* projections. This reduced the risk that domestic demand would grow faster than had

been built into the central projection. The latest provisional Royal Institute of Chartered Surveyors' (RICS) survey pointed to a further reduction in the balance of estate agents reporting price increases in May, although the balance remained strongly positive. The recent pattern of slower growth in southern regions relative to the north had continued, in contrast with the picture a few months ago.

10 The mortgage approvals data had weakened in April. However, the figures might be affected by the number of working days in April and, therefore, the fall might be reversed in May, just as the weakness in December had been reversed in January. The House Builders' Federation survey of site visits and reservations still pointed to a slight fall in particulars delivered later in the year. The provisional estimate of mortgage equity withdrawal for Q1 was weaker than in Q4, and was consistent with some slowdown in consumption growth.

11 Corporate borrowing growth had again been strong, but it was unclear quite why this was so. One possibility was that it reflected a shift between sources of financing, away from bonds and equities towards bank lending. Another possibility was that the higher borrowing could also reflect a squeeze on profits and hence a tighter liquidity position. Profits had fallen in the first quarter according to the preliminary estimate by the Office for National Statistics (ONS). A fall in final demand, and hence company income, could be consistent with a rise in stocks – but the relationship between the stock-output ratio and corporate borrowing had not been particularly close over recent quarters. In addition, the recent special survey by the Bank's regional Agents had found little evidence of higher borrowing because of worse cash flow. A third possibility was that higher borrowing was being used to finance current or prospective investment. Although total investment had been a little weaker than expected in Q1, business investment had grown quite strongly.

Demand and output

12 Final domestic demand in Q1 had been weaker than expected at the time of the *Report*. The annualised six month growth rate was now running at around 3½% compared with about 4½% at the same time last year – a significant slowdown but still robust. The weakness was broadly based across consumption, investment and government spending. The key question was how persistent the slowdown in the Q1 figures would prove to be.

13 In the case of consumption, the Q1 figures looked a little low in the light of the retail sales data and other indicators, although the continuing weakness of car registrations through Q1 might explain part of the difference between retail sales and total consumption growth. At some point household spending on vehicles would recover, and hence the current growth rate might be erratically low. More recently, retail sales had been weak in April. But the latest CBI distributive trades survey and evidence from the British Retail Consortium suggested that retail sales in May would be stronger. The Bank's regional Agents' contacts reported early signs of an easing in retail sales growth while consumer services growth remained strong. Both the GfK and MORI consumer confidence indicators had risen slightly – though they were not far from their long run averages once seasonal factors were taken into account. Although slower house price growth and recent movements in equity prices suggested a prospective weaker contribution from household wealth to consumption growth than had been the case over the past few years, this had already been incorporated into the Committee's projections. Real earnings growth continued to support consumption growth.

14 On government spending, some weakness in the first quarter had been expected in the light of recent monthly data, and a return to positive growth would be needed if Government spending plans were to be met. There had, more generally, been some recent revisions to the fiscal numbers, with spending having undershot and revenue having overshot the projections made in the March Budget. More revisions to the estimates of real and nominal government spending were possible when the National Accounts are published on 29 June. The revised data and any possible implications for future government spending and revenue projections would need to be incorporated into the August *Inflation Report* forecast.

15 Inventories had made a much stronger than expected contribution to GDP growth in Q1, and this had been broadly spread across the manufacturing, wholesale and distribution sectors. It could reflect weaker-than-expected demand and indicate weaker output growth ahead, but it was too early to say. There were no signs of widespread stockbuilding from either the Agents' contacts or surveys. No details of the alignment adjustments had yet been published by the ONS, but it was possible that these adjustments, or other temporary factors, were contributing to a stronger contribution from inventories in Q1. If so, the positive contribution might well be reversed in Q2, with little consequence for output growth in the first half of the year as a whole.

16 The positive contribution from net trade to GDP growth was only slightly weaker than expected in Q1, although both export and import volumes had been stronger than expected. There seemed to be little news on the month and the puzzle remained of why net trade was so strong given the previous strength of sterling. The quarterly figures were nonetheless volatile from quarter to quarter, so that caution was needed in placing weight on the Q1 figures.

17 The picture for GDP growth was further complicated by the weakness of energy output in the first quarter, which may have reflected the weather. This suggested that the underlying pace of output growth was stronger than recorded in headline GDP growth. The industrial production numbers for April showed manufacturing moving broadly in line with expectations, but there had been a sharp rise in energy output. That seemed consistent with stronger Q2 GDP growth, all other things being equal.

18 There were significant discrepancies between the estimated Q1 growth rates of the output, income and expenditure measures of GDP, which were difficult to reconcile. The release of the National Accounts for Q1 and the annual rebalancing exercise for the ONS *Blue Book* might help resolve this.

19 Overall, the pace of final domestic demand had slowed more than expected in Q1, but it was too early to judge whether this would be sustained into Q2.

The labour market

20 There had been a slight moderation in employment growth, and it seemed likely that average hours worked had fallen in the first quarter. But other data pointed to a slight tightening in labour market conditions. The Recruitment and Employment Confederation survey had shown an intensification of labour market shortages. While the Labour Force Survey measure of unemployment had been unchanged, there had been a further fall in the claimant count measure.

21 There had been a slight pick up in pay settlements, with the three-month mean measure rising to 3.0% in April. The twelve-month mean measure had, however, continued to fall and was now at 3.2%. Average earnings growth had fallen back to 5.8% in March on the headline measure, and was below the figure for Q1 in the May *Inflation Report* central projection. If the fall persisted it might

imply a slightly lower profile for earnings growth and hence a slightly lower central projection for inflation over the next two years. At the least, it appeared that the upside risks to the May projection had diminished. However, taken at face value, the latest hours data implied that hourly earnings were rising even more rapidly in Q1, by around 7¼% at an annual rate, although it was recognised that this calculation was particularly subject to considerable measurement error.

22 Productivity growth had been rising, and the annual rate of growth of output per head had probably risen to around 1¾% in Q1, while the estimate of growth in productivity per hour was around 3%. This month's special survey by the Bank's regional Agents suggested that many companies planned to purchase and sell on the internet over the next few years, and this might support future productivity growth.

23 The real product wage (on the basis of the GDP deflator) was growing at around 2½% and was currently above estimates of average historical productivity growth. Whole economy unit labour costs had been rising by around 4% per annum, and were rising in real terms. This entailed a continuing squeeze on the profit share of GDP over recent years, which was unsustainable in the long run. On these measures the labour market continued to look tight. One way in which the tension could be resolved would be a continued fall in earnings growth.

Prices and costs

24 RPIX inflation had fallen to 1.9%, consistent with the central projection in the *May Inflation Report*. The gap between goods and services inflation had narrowed, primarily due to the reductions in utility prices and the timing of duty increases on goods. The latest Bank estimates suggested that there had been a further squeeze on both manufacturing and retail margins. That was supported by the Bank's regional Agents' contacts reporting that they were still having difficulty passing through rises in input costs to their output prices. In the case of manufacturing, in particular, the squeeze on margins was reported as having increased the pressures on firms to raise productivity growth over recent quarters.

25 The short-term outlook was for rather higher RPIX inflation than at the time of the *Inflation Report*. This was partly on account of the rise in the oil price, but this had no obvious implications for the medium term projections. But the main news on the month had been the sharp fall in the

exchange rate, which would tend to push inflation back up towards the 2½% target faster than had been expected in May.

26 The British Retail Consortium's shop price index showed retail prices falling 1.2% in the year to May. The CBI Distributive Trades survey quarterly questions on reported and expected movements in retail prices also showed a marked decline in the balances between February and May, and the level of the balances was now at a record low. However, these indicators primarily related to retail goods price inflation, which continued to be much weaker than that for services. The latest Chartered Institute of Purchasing and Supply (CIPS) services survey indicated a sharp rise in the price index in May. But since the CIPS services survey primarily reflected business-to-business transactions, such strength might take some time to feed through to retail prices.

Tactical considerations

27 There was little expectation in financial markets that the Committee would raise interest rates this month, although there was still an expectation of higher rates in the future. So a decision to raise interest rates this month would come as a surprise to the markets and might change expectations. In such circumstances it would be necessary to consider possible effects on the exchange rate and hence the likely consequences for inflation in the medium term.

28 Previously when the markets had been surprised by a change in interest rates, there had sometimes been a marked change in the exchange rate in the weeks that followed. This might suggest that the exchange rate would appreciate significantly even in response to a 25 basis point rise in interest rates this month. But, in these past examples, it was difficult to isolate the effects of the interest rate decision from the flow of other news affecting market perceptions. It also mattered what market expectations were concerning the decisions at the next ECB and FOMC meetings. If one, or both, surprised the market by raising interest rates more than expected, and UK interest rates were not changed this month, then sterling might depreciate further.

The overall conjuncture

29 An important question was how far the evidence over the month suggested that a rebalancing of the economy was in prospect. There were signs of slowing domestic demand and stronger net trade

in the first quarter. There was also the prospect of somewhat stronger net trade in the future given the depreciation of sterling over the past month. So the depreciation of sterling from an unsustainable level was welcome. The important issue for the Committee was what this past and prospective rebalancing of the economy implied for inflation over the next two years or so. How large an effect on inflation would be caused by the exchange rate depreciation? This was especially difficult to know given the uncertainty in gauging pressures on profit margins. Were the signs of slower domestic demand and lower earnings growth sufficient to indicate that domestic inflationary pressures were weaker than previously thought?

30 The effects of real exchange rate changes would typically first be seen on prices and only later on net trade. A weakening in domestic demand would take some time to feed through to lower inflation. So, taken at face value, the recent rebalancing might, other things being equal, raise the prospect of inflation moving closer to target over the next few quarters, assuming the fall in sterling was sustained. Further out, the effects on inflation of the exchange rate depreciation and a possible weakening of domestic demand would need to be carefully weighed.

31 Other indicators, such as the gap between service sector and industrial production growth in the first quarter, suggested that the economy was far from being in balance. Indeed, the sterling ERI had only fallen back to its November 1999 level. There was also uncertainty about whether sterling had truly decoupled from the dollar and hence was being influenced by domestic factors, and therefore about how far it would move if the dollar/euro exchange rate changed significantly. The evidence from options markets suggested that the implied correlation between the dollar and sterling was expected to be stronger twelve months ahead than one month ahead, suggesting that the markets anticipated a degree of recoupling.

The immediate policy decision

32 One view was that interest rates should be maintained at 6% this month. The most significant development over the month had been the fall in sterling. Treating the recent exchange rate depreciation in the same way as the previous appreciation suggested that inflation would be higher than projected in May. However, in the view of some, not all of the fall in sterling should be treated as an exogenous fall in the real exchange rate, and some of the depreciation might be attributed to changes in the market's expectation of future UK inflation. The overall effect of the exchange rate

depreciation on inflation was highly uncertain, especially if overseas exporters' margins to the UK fell more sharply than previously expected and if retail margins were squeezed further. Raising interest rates this month might push sterling up again and exacerbate the undershoot of inflation against the target in the near-term, while simultaneously aggravating the potential size of the inflationary shock further out as sterling would fall from a more elevated level.

33 Some of the other indicators suggested that domestic inflationary pressures might be showing signs of easing more than expected. For example, final domestic demand growth had been weaker than previously expected in Q1. Retail sales had also been weak in April, although indicators pointed to a resumption in growth in May. The housing market seemed to have slowed, which appeared consistent with slowing consumption growth. The release of the National Accounts data for Q1 on 29 June might help clarify the extent of the slowdown. Earnings growth had so far turned out weaker than in the central projection – although other indicators suggested that the labour market remained tight. While the depreciation would, other things being equal, lead to higher inflation looking further out, inflation was still below target and likely to be so for some time. There was no need for a rise in interest rates this month, and for some members no presumption that a further rise would be needed. The depreciation of sterling would help bring about a rebalancing of the economy, and that was welcome even if it meant that at some point higher interest rates were needed. Even those members who thought that a further rise in interest rates might eventually be necessary noted that the costs associated with waiting were low in comparison to the costs that would be incurred by moving now and potentially exacerbating sterling's overvaluation.

34 The alternative view was that, on balance, the data this month required a rise in interest rates of 25 basis points. The effect of the depreciation of the exchange rate on prospective inflation was significant and was not offset by the other news. The slowdown in final domestic demand in the first quarter was probably partly erratic and should not significantly change the outlook, although the upside risks seemed to have diminished since the *May Report*. The bounce-back in industrial production at the start of Q2 was consistent with a recovery in demand and output growth in Q2. The latest evidence was still consistent with consumption growing close to trend, as projected in May. The labour market was tight on most measures. It was not sensible to place too much weight on the fall in earnings growth in March and there was still a risk that earnings could turn out stronger than the deceleration in the May central projection. Given the recent depreciation of sterling, the downward pressure on retail prices from the past appreciation of sterling would cease. Although

measures of domestically generated inflation had fallen they remained above the 2 ½% target, so that a slowdown in private sector domestic demand growth was still required. Against this background, the data pointed to higher inflation than thought a month ago. Were there, nevertheless, reasons for waiting? The exchange rate depreciation could reverse; there was a risk that a rise in interest rates would be misinterpreted as being linked to the exchange rate depreciation in a mechanical way; a rise in rates might lead to an appreciation of sterling if it surprised the markets; and some of the demand and output puzzles might get resolved through the release of the *Blue Book* data. While these outcomes were all possible, none seemed sufficiently compelling to delay action warranted by the data. For these reasons a rise in interest rates of 25 basis points was desirable this month.

35 The Governor invited members to vote on the proposition that the Bank's repo rate be maintained at 6.0%. Six members of the Committee (the Governor, David Clementi, Christopher Allsopp, DeAnne Julius, Ian Plenderleith and Sushil Wadhvani) voted for the proposition. Mervyn King, Stephen Nickell and John Vickers voted against, preferring a rise in rates of 25 basis points.

36 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 1 June in advance of its meeting on 6-7 June 2000. Bank staff also briefed the Committee on the latest outside forecasts available as of 1 June. 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 US industrial production had grown strongly during April, and consumer confidence in May had been strong. The National Association of Purchasing Managers' (NAPM) index had fallen in May, largely because of a sharp fall in the new orders component of the index from 56.3 to 51.1, though the production index had also fallen. The indices for inventories and employment had risen slightly in the month. Retail sales had fallen slightly in April, the first monthly fall since August 1998. The US trade deficit had widened further in March. Trade volumes had risen strongly, with export growth slightly higher than import growth. The unemployment rate in May had risen to 4.1%, from 3.9% in April. Non-farm payrolls had risen by 231,000, although this had been boosted by an additional 357,000 workers recruited for the Census. Unit labour costs had increased in the first quarter, partly due to a slowing in productivity growth.

A3 GDP in Germany and France had grown by 0.7% in Q1. In the euro area as a whole both business and consumer confidence had remained at historically high levels. The euro-area unemployment rate had fallen to 9.2% in April, its lowest rate since September 1992.

A4 In Japan, many estimates of GDP in Q1 had pointed towards strong growth, following negative growth in Q3 and Q4 of 1999. In April, industrial production had risen by 7.8% on a year earlier. A sharp fall in public construction orders during April had indicated that the fiscal package may have been front-loaded into Q1. Nominal retail sales had declined in the year to April. The trade surplus had widened in April. Exports had risen slightly faster than imports,

driven by strong demand in Asia and the United States. On an unadjusted basis, nominal wages had increased in the year to April by 1.4%. The unemployment rate had fallen to 4.8% in April, but inactivity had risen as employment fell.

A5 Oil prices had risen during the month, with Brent crude oil trading within a \$25-\$30 range. Prices for non-oil commodities had also risen in the month.

A6 In the United States, the CPI price index had remained unchanged on the month in April although the annual rate of CPI inflation had fallen from 3.7% to 3.0%, mainly reflecting a fall in energy prices. Core CPI inflation (which excludes food and energy) had fallen to 2.2%, while headline producer price inflation had fallen to 3.9%. The level of average hourly earnings had increased by 0.1% in May, following a 0.4% increase in April. Euro-area headline inflation had fallen to 1.9%, although core inflation (which excludes energy, food, alcohol and tobacco) had risen slightly. Euro-area headline producer price inflation had risen to 6.2% in March. In April, Japanese consumer price inflation fell to -0.8%.

A7 M3 in the euro area had remained buoyant in April, increasing by 6.5% on the year, while credit to the private sector had increased by 11.4%. The three-month moving average of M3 growth had reached its highest rate since the introduction of the euro. Japanese M2 including CDs had increased by 2.9% in the year to April, a pick-up from March, partly due to a slight reversal in the decline of bank lending.

A8 Since 3 May, the euro and yen effective exchange rate indices had appreciated by around 6% and 1% respectively, while the dollar effective exchange rate index had depreciated by around 3%. Over the same period the Wilshire 5000 index – a broad measure of the US stock market – had increased by just under 3% and the NASDAQ index, which has a higher proportion of technology stocks, ended the month close to its value on 3 May. In Japan the Topix index had fallen by over 6%. Interest rates implied by futures contracts had fallen on the month in the United States. In the euro area, there had been little change in rates implied by futures contracts maturing this year.

II Monetary and financial conditions

A9 The twelve-month growth rate of notes and coin had continued to fall slightly from 8.2% in April to 7.9% in May. This figure was just below the underlying 8%-9% range that had been observed over recent months.

A10 M4 had risen by £5.1 billion (0.6%) in April, compared with £13.8 billion (1.7%) in March, remaining strong despite the unwinding of large repo transactions that took place in March. The increase had been driven by continued growth in M4 excluding Other Financial Corporations (OFCs). Aggregate M4 lending (excluding the effects of securitisations) had also been strong in April, rising by £6.7 billion (0.7%), despite the unwinding of March reverse repos.

A11 The gap between M4 lending and M4 had continued to rise in April and was close to historical highs at just under 6% of GDP. The main factor financing this rising gap had been net inflows from overseas residents.

A12 Household M4 lending (excluding the effects of securitisations) increased by £4.2 billion (0.7%) in April, compared with an average monthly increase of £4.8 billion in 2000 Q1. Both loan approvals and net secured lending to individuals had declined markedly in April.

A13 Provisional estimates by Bank staff had suggested that mortgage equity withdrawal in 2000 Q1 was down slightly from the estimates for the previous few quarters. Total lending for consumption (mortgage equity withdrawal plus unsecured lending) was also estimated to have fallen.

A14 Net new bank borrowing (bank borrowing minus bank deposits) by PNFCs (private non-financial corporations) had been negligible in April, although there had been significant increases in both deposits and borrowing. A broader measure of PNFCs' external borrowing (including capital issues and foreign currency borrowing) had increased further in April following the strong borrowing in 2000 Q1.

A15 Since the previous MPC meeting, short interest rate expectations, as measured by the two-week gilt repo curve, had fallen slightly at the very short end. Longer nominal interest

rates had remained broadly unchanged. Corporate bond spreads had continued to widen this month, with corporate bond yields up at all maturities.

A16 There had been little change in short or medium-term inflation expectations. Fixed end-point surveys of expected inflation for 2000-04 had remained slightly below the inflation target.

A17 The FTSE All-Share index had risen by 5.4% since the previous MPC meeting. The rise on the month had been mainly attributable to the non-cyclical services, resources and financials sectors. Despite declining significantly since the beginning of the year, the FTSE IT sectoral index had outperformed the All-Share over the previous twelve months.

A18 Since the previous MPC meeting, sterling had depreciated by 9.3% against the euro and by 2.5% against the dollar. The sterling effective exchange rate index (ERI) had fallen by 7.7%. The recent declines in the sterling-euro and sterling-dollar exchange rates could not be accounted for by changes in interest rate differentials over the month.

III Demand and output

A19 GDP growth in Q1 had been revised up to 0.5% (from 0.4%). The annual growth rate had risen to 3.1%, the fastest rate since 1997 Q4. Total industrial production had fallen by 0.8% in 2000 Q1, with manufacturing output down by 0.5%. Service sector output had risen by 0.8% and construction output by 0.5%. Agricultural output growth had fallen by 1.1%.

A20 The expenditure breakdown showed that domestic demand had risen by 0.4% in Q1. Final domestic demand had risen by 0.3%.

A21 There had been an unusually large discrepancy in Q1 between the growth of GDP as measured by expenditure compared with the average measure, with the expenditure measure stronger.

A22 Private consumption (including that of non-profit institutions serving households) had grown by 0.6% in Q1 and had increased by 3.2% in the year to 2000 Q1. Government

consumption had fallen by 0.4% in Q1. Total investment (including acquisitions less disposals of valuables) had decreased by 0.1%. Business investment had increased by 1.9%. Within this, manufacturing investment had increased by 4.9% in Q1, while private service sector investment had risen by 2.7%. By implication the government and private sector dwellings components of investment had been weak. The gross operating surplus of corporations had decreased by 1.8%.

A23 Inventories had made a small positive contribution to GDP growth in 2000 Q1. Including the alignment adjustment, inventories had risen by £0.6 billion. Most sectors had experienced an increase in their inventories. The CBI Monthly Trends survey in May had reported that manufacturers still perceived their stocks to be more than adequate, though their balance was below the long-run average.

A24 Net trade had contributed 0.3% to GDP growth in 2000 Q1. Total exports of goods and services had increased by 3.2%, and imports had increased by 2.0% in Q1. Exports of goods had risen by 2.3% in March, and imports were also 2.3% higher. Goods exports to and imports from non-EU countries had both risen by around 3% in April.

A25 Turning to indicators of Q2 activity, manufacturing output had fallen by 0.2% in April. But total industrial production had risen by 0.8%, reflecting a large rise in energy sector output. Retail sales volumes had fallen by 0.3% in April but had risen by 4.5% on a year earlier in the three months to April. The CBI Distributive Trades survey had shown a total balance of +45 retailing respondents reporting higher sales in April compared with a year ago and further growth was expected in May. The British Retail Consortium survey had reported an increase in May. The MORI measure of consumer confidence had risen to -11 in May while the GfK confidence index had increased to +2.7 from -3.8 in April. Private new car registrations in the three months to April had fallen by 3.5% on a year earlier, while total new registrations had increased by 1.1%.

A26 The housing market indicators had shown signs of a slowdown. Both the Halifax and Nationwide Prices indices had fallen by 0.4% in May. Annual rates, though still high, had fallen, as had three-month rates. The Nationwide three-month rate had only fallen a little and remained high at 5.0%, but the Halifax three-month rate had fallen sharply to zero. A preview of the Royal Institute of Chartered Surveyors (RICS) survey of estate agents for May had shown

a fall in the balance reporting house price rises. The balance in April had fallen to 37 from 60 in March. The House Builders' Federation (HBF) survey balance for house price inflation had shown a fall to 33 in April from 52 in March. Particulars delivered had fallen by 8.7% in April and were 3.3% on a year earlier. HBF site visits and reservations had fallen in April. Private housing starts had risen by 5.3% in March, but completions had fallen by 1.4%.

A27 The public sector net cash requirement had been -£6.7 billion in April (a surplus). Net investment and net borrowing had been revised down by £2.2 billion for 1999/00.

A28 The manufacturing output expectations balance in the CBI Monthly Trends survey had decreased to -6 in May from +1 in April. The total orders balance had increased to -10 in May but the export orders balance had decreased to -35.

A29 The headline index of Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey output had been 50.9 in May. The growth in new orders had slowed to 51. The DHL survey had eased to +34 in May from +38 in February. The headline CIPS services survey balance had been +59.2 in May. The CIPS construction index had risen to 62.2 in May.

IV Labour market

A30 Employment had continued to grow steadily. Labour Force Survey (LFS) employment had increased by 55,000 (0.2%) in 2000 Q1 compared with 1999 Q4. The increase had been accounted for by higher part-time employment, which had risen by 54,000. So employment growth had been lower in full-time equivalent terms. The working-age employment rate had risen by 0.1 percentage points to 74.4%.

A31 Hours worked by full-timers had fallen steeply in Q1 (by 1.1%), though those of part-time workers were broadly unchanged. Average hours worked had fallen by 1.0%. Total hours worked had fallen by 0.8%, despite the increase in the headcount, and were 0.3% lower than in the same period a year earlier.

A32 The CIPS surveys in May had indicated continued strong employment growth in both services and construction, and a slower decline in manufacturing employment. The Recruitment and Employment Confederation (REC) survey had indicated that shortages of both temporary and permanent agency staff had intensified in May. According to the Bank's regional Agents skill shortages remained a concern, especially in the Greater London area.

A33 Unemployment had fallen on both the ILO and claimant count measures. LFS unemployment had fallen by 20,000 in Q1, with the rate down 0.1 percentage points to 5.8%. Claimant count unemployment had fallen by 28,800 in April, lowering the rate to 3.9%. The fall in ILO unemployment had been more than accounted for by lower long-term unemployment: short-term unemployment had risen by 17,000.

A34 Inactivity had been broadly flat, rising by only 1,000 in Q1 compared with the previous three months. An increase of 24,000 in male inactivity had offset a fall of 23,000 in female inactivity. Female working-age inactivity had fallen steadily since 1995, while male inactivity had been broadly stable for the previous two years.

A35 Annual manufacturing productivity growth had slowed to 3.8% in March. Unit wage costs in manufacturing had started to increase again. Annual growth in whole-economy productivity and unit wage costs in 2000 Q1 was estimated, using LFS data, to be 1.7% and 4.0% respectively.

A36 Earnings growth as measured by the average earnings index (AEI) had fallen back slightly. Whole-economy headline earnings growth (three-month average of annual growth rates) had fallen by 0.2 percentage points in March to 5.8%. The private sector accounted for all of this decrease (down 0.3 percentage points to 6.2%). Headline earnings growth had fallen in both private services and manufacturing, to 6.6% and 4.9% respectively. Headline public sector earnings growth had been unchanged at 4.2%.

A37 Annual earnings growth had edged down by 0.1 percentage points to 5.4% in March. This was accounted for entirely by public sector earnings growth, which had returned to pre change in millennium rates. Growth excluding bonuses (not seasonally adjusted) was 4.7%, down from 5.1% in February, with a bonus contribution of 0.9 percentage points. The Bank's

estimate of annual growth in earnings per hour had continued to rise in Q1 and was now above 7%. The widening gap with the headline earnings growth figure was accounted for by the fall in average hours worked, which were 1.3% lower than the previous year.

A38 The REC survey had pointed to a slowdown in the rate of growth of permanent placement salaries in May. Growth rates for temporary staff had picked up a little.

A39 Settlements had picked up but remained lower than a year ago. The Bank's three-month AEI-weighted whole-economy mean had risen by 0.2 percentage points to 3.0% in April, reflecting a rise in private sector settlements. Settlements in Q1 had generally been lower than during the same period last year: of the 56 settlements that could be matched, 18 had been higher, 11 had been the same and 27 had been lower. The Bank's twelve-month mean had fallen by 0.2 percentage points to 3.1%. Public and private sector means were also 3.1%.

V Prices

A40 The Bank oil-inclusive commodity price index had fallen by 7.0% in April, the largest fall since the start of the series in 1990, taking the annual inflation rate from 20.5% down to 8.9%. The large monthly decrease had reflected large falls in the prices of fuels and metals. The fuels component of the index had fallen by 11.9% in April, largely accounted for by the fall of around 15% in the oil price in April. Non-oil commodity prices had fallen by 3.1% in April, and by 0.2% over the past year.

A41 Seasonally adjusted manufacturing input prices had fallen by 3.2% in April, taking the annual inflation rate from 13.1% to 7.1%. The large monthly fall had mainly reflected the decline in the price of crude oil in April. There had also been falls in the prices of metals and of imported materials as a whole. The CIPS manufacturing survey input price index had fallen significantly in May. Seasonally adjusted total output prices excluding excise duties (PPIY) had fallen by 0.1% in April. The annual inflation rate had been 1.6%, slightly down from 1.8% in March. As in previous months, petroleum product prices had risen, but this had been more than offset by small falls in the prices of a large number of components. May's CBI Industrial Trends Survey output price balance had fallen significantly from -13 to -21. The Corporate Services Price Index had risen by 0.7% in 2000 Q1 compared with a rise of 1.1% in 1999 Q4, taking the annual inflation rate to 3.6%, slightly down from 3.9% in the previous quarter.

A42 The prices of imported and exported goods had risen by 1.1% and 0.3% respectively in the three months to March compared with the previous three months. Excluding oil, the price of imported goods had risen by 0.5%, while the price of exported goods had fallen by 0.9% over the same period.

A43 RPIX inflation had fallen to 1.9% in April, down from 2.0% in the previous month. This had largely reflected lower petrol price inflation and cuts in utilities prices. RPI inflation had risen from 2.6% to 3.0%, following the abolition of MIRAS in April. RPIY inflation had fallen to 1.6% in April, while HICP (harmonised index of consumer prices) inflation had fallen from 0.7% to 0.6%. The difference between RPIX and HICP inflation had remained constant at 1.3 percentage points.

A44 The British Retail Consortium (BRC) Shop Price Index had fallen by 0.2% in May, taking the annual inflation rate to -1.2%, down from -0.7% in April. The CBI Distributive Trades retailers' reported average selling price balance had fallen from -4 in February to -6 in May, its lowest on record.

VI Reports by the Bank's Agents

A45 The Bank's regional Agents had reported that growth in manufacturing output and orders, although still continuing, had slowed further. Service sector output growth had remained strong, particularly in professional services, IT and telecommunications. Moderate export growth was still being recorded. In contrast to recent official data, the Agents reported that import growth had continued to strengthen. Construction activity remained strong, although growth had eased slightly in recent months. Within the sector, demand for housing and industrial property was reported to have eased. Agents had reported early signs of an easing in annual retail sales growth, although the sector remained difficult to read in many regions. Manufacturing investment intentions had weakened further, but those in the services sector had remained strong.

A46 Downward pressure on manufacturers' output prices and margins had continued, particularly in export markets. But stronger pay pressures in some areas of the service sector

had been passed through to prices. Retail goods prices were reported to have continued to fall slightly. The Agents suggested that house price growth in the southern regions of the United Kingdom had slowed markedly recently, although in other regions (where the pace of house price growth had been relatively slower), growth remained stable. Contacts remained concerned about skill shortages in the labour market, although the incidence of shortages had remained broadly unchanged in recent months.

A47 The Bank's regional Agents had conducted a survey of UK firms regarding e-commerce. More than 80% of firms reported that they already had a web site, and all others were planning to develop one within two years. Most companies commented that their site was used as a marketing tool and was not used to conduct sales. Only a small proportion of firms reported that any of their input purchases were conducted via the Internet at the moment, but many reported that they already used EDI (electronic data interchange) technology. Of existing Internet sales, business-to-business (B2B) volumes were reported to vastly outweigh those of business-to-consumer (B2C). Purchases and sales over the Internet were expected to increase over the next two years, particularly in areas such as purchases of construction and manufacturing materials and business travel. However many firms stated that transactions would continue to take place in the conventional way.

VII Market intelligence

A48 Expectations of short-term UK interest rates in the rest of 2000 and for 2001, implied by short sterling futures, had fallen by 5-13 basis points since the May MPC meeting and by 17-20 basis points for contracts maturing in 2002 and 2003. Weaker-than-expected domestic and international data had contributed to the fall. The market consensus was for UK official rates to be left unchanged in June. In reaching this view, most market participants had referred to the weaker-than-expected average earnings and retail sales data for March and April respectively, as well as survey evidence suggesting a slowdown in house price inflation. But the market continued to expect at least one more 25 basis point rate rise, perhaps two, in 2000. The fall in sterling, higher oil and commodity prices and the continued high *level* of average earnings growth lay behind these expectations.

A49 Sterling's effective exchange rate had fallen by 7.7% since the previous MPC meeting, to below its level at the start of the year. Sterling had depreciated against both the dollar and the euro. Changes in UK interest rate expectations this month had not been significantly different from those in the euro area and the United States, indicating that other factors lay behind the sharp movement in sterling. Economic prospects in the United States and euro area had remained strong, and the market may have regarded the level of sterling reached in early May as an aberration. There were also shorter-term factors cited by market participants. First, merger and acquisition flows had, on balance, been negative for sterling this month. Second, it appeared that some overseas investors may have had overweight positions in sterling and reduced them slightly. Third, technical and momentum traders may have accelerated the fall in sterling once the change in direction of the currency was clear, having previously accelerated the rise.