

Publication date: 22 March 2000

MINUTES OF MONETARY POLICY COMMITTEE MEETING 8 and 9 March 2000

These are the minutes of the Monetary Policy Committee meeting held on 8 and 9 March 2000.

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0003.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 April will be published on 19 April 2000.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING ON 8-9 MARCH 2000

1 Before considering the implications of the latest data for the immediate policy decision, the Committee discussed the implications of the forthcoming Budget; recent developments in demand and output; money and asset prices; the labour market; prices and costs; the world economy; other forecasts of the UK economy; and other considerations.

The Budget

2 The Committee had been briefed by Treasury officials prior to its meeting on the broad shape of the forthcoming Budget's macroeconomic projections and public finances. The fiscal outturn for 1999/2000 was tighter than had been expected at the time of the Pre-Budget Report, but much of that tightening had already happened and was in the data. Essentially, the broad picture was one of both higher tax revenues and lower public spending. The Treasury's estimates were for the cyclically-adjusted Public Sector Net Borrowing Requirement for 1999/00 to be almost 1% of GDP tighter than thought at the time of the November Pre-Budget Report, and looking forward that it would remain some ¼% to ½% tighter over the next two fiscal years.

3 The Budget's spending profile assumed that the current fiscal year's underspending would be made up in subsequent years, but spending was otherwise broadly unchanged as a share of GDP in aggregate terms since the Pre-Budget Report. There had, however, been some changes within the aggregate. In particular, lower social security spending – lower transfers to the household sector – was offset by higher government consumption spending. Since the marginal propensity to spend out of these transfers was likely to be quite high, the demand-weighted impact of these changes might be broadly offsetting.

4 The Committee discussed the possible implications for inflation. Three factors were discussed. First, much of the tightening was already in the data. So the relationship between, for example, consumption and post-tax income was different from that expected at the time of the Pre-Budget Report, and would need to be re-examined in the next *Inflation Report* forecast round. Second, since the reasons for the rise in tax revenues were not well understood, it was possible that those higher revenues would not persist – statutory tax rates had not been raised. However, it was noted that the fiscal projections were, as usual, produced on the basis of cautious assumptions, for example that the ratio of VAT to consumption would fall somewhat over the period of the projections, albeit from a higher starting point. Third, it was possible that higher tax revenues

indicated higher activity than currently recorded in the national accounts, rather than an increase in effective tax rates. The implications of this for inflation depended in part on whether any under-recording of output was matched by a commensurate under-estimate of potential output.

5 Overall, the broad fiscal picture looked somewhat tighter than had seemed probable a month ago. The impact on future activity and inflation seemed to be fairly small, although that would, in part, depend on whether the Budget had any lasting effect on sterling's exchange rate. More analysis would be needed once the full details of the Budget were known.

Demand and output

6 Prior to the recent release of 1999 Q4 output and expenditure data, the picture had been one of a gradual slowing in the annual rate of growth of final domestic demand from around 4½% to around 3% - 3½%. The latest data showed that the rate was now back in the 4% - 4½% range at the end of 1999, on account of upward revisions to both consumption and investment. Considered in this way there was less evidence that final domestic demand was slowing to a more sustainable pace. However, it was possible to analyse the data in a variety of different ways. For example, smoothing the data over two quarters still suggested a moderation in the rate of growth during 1999. Furthermore, the growth rate of final domestic demand in the fourth quarter had been in line with the February *Inflation Report* central projection.

7 There was a 1.2 percentage point negative contribution from net trade to GDP growth in Q4, much larger than expected. This, in turn, had been offset by a stronger-than-expected contribution from inventories, so that total domestic demand growth was much stronger than expected. It was possible that these two factors were linked, as the increase in stocks might be import-intensive. In addition, some of the change in net trade on the quarter might be erratic. Nonetheless net trade looked weaker than had been previously thought and possibly reflected quicker or larger effects from the most recent appreciation of sterling, or a delayed response from the past appreciation of sterling. This suggested that even if the overall pace of output growth was as expected, the mix of aggregate demand – between domestic demand and net trade – now looked less benign than it had appeared a few months ago when the net trade contribution had for a while been positive.

8 On inventories, it was possible that the increase might also prove to be erratic. It was still difficult to assess the size of the millennium effects. In addition, the change in manufacturing, wholesale and distribution stocks did not account for much of the aggregate change in inventories over the quarter. The increase was largely accounted for by 'other' industries, which included the quarterly statistical alignment adjustment. The rise in stocks in these industries in Q4 might also be linked to the recent weakness of car registrations. If, for example, the number of car registrations

eventually recovered to its former level, then the underlying picture for consumption would have been stronger (and inventories weaker) than recorded. The change in seasonal pattern following the change to new car registration practice last year also made comparisons difficult.

9 Overall the latest indicators of demand and output gave a rather mixed picture, with some remaining strong and others weakening. Many of the strong indicators pointed to continuing buoyancy of domestic demand. In particular, real earnings growth had been strong and wealth continued to rise. The GfK consumer confidence index had fallen on the month, but this was as expected following its surge in January and the index remained close to the level it had been at throughout 1999. The latest CBI Distributive Trades survey pointed to both a strong outturn for February and an expectation of a strong March. However, the Bank's regional Agents had detected a mixed retailing picture in February. In aggregate, retail sales growth had continued at broadly the same pace, but with some regions reporting stronger and others weaker growth.

10 A number of indicators on the output side showed perhaps greater signs of a slowdown in the rate of growth, many reflecting the recent weakness in net trade. Industrial production had been weak in January and there had been small downward revisions to earlier quarters. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing activity index had fallen slightly in February and had therefore remained well below its level in Q4 – though it remained above the neutral 50 level. The OECD leading indicator for the UK had also turned lower. It was possible that the recent weakness in some of the output indicators might slow income growth and, in turn, domestic demand. By way of contrast with weaker industrial production data, the latest CIPS services and construction indices had continued to show strong growth and the 3i survey had shown business optimism to be strong.

Money and asset prices

11 Broad money was growing at the slowest annual rate of growth since July 1983, when the monthly figures had first been published. In addition, the disaggregated data indicated that this month, unlike in recent months, Other Financial Corporations could not account for the reduction in the aggregate M4 growth rate. It was possible that some of the weakness in household and corporate deposits was accounted for by the unusual seasonal timing of tax payments which might prove temporary, and it would therefore be useful to see another month's data before drawing any conclusions. The large financial deficit of the corporate sector was another possible contributing factor.

12 By contrast growth in lending remained strong. Household credit growth, in particular, was breaking records, with annual growth at 10% the highest since the early 1990s. In the housing

market, both the number and value of approvals for house purchase had fallen on the month, but there was uncertainty as to whether this was a stronger than normal seasonal effect around the year-end. Corporate borrowing also remained strong. There were few signs of significant financial stress in other indicators. While the latest evidence showed that the corporate sector financial deficit as a percentage of GDP was quite large by historical standards, the special survey conducted by the Bank's regional Agents had found little evidence of distress borrowing, and suggested that companies were borrowing to invest.

13 Exchange rates between the dollar, euro and yen had been volatile over the past month. Although there were further signs of stronger activity in the euro area, there had been continued signs of even stronger activity in the United States, so it was perhaps not too surprising that the euro had remained weak. Some of the recent strength of the yen against the dollar might be related to year-end repatriation effects, which could prove temporary. It was perhaps surprising that sterling had not moved much over this period, despite large movements in other currencies. The sterling effective exchange rate index had risen a little compared with the time of the Committee's previous meeting, but was broadly in line with the assumption underpinning the central projection in the February *Report*. However, during the month sterling had reached its highest-ever level against the euro, and a seven-month low against the dollar. Looking over a longer period the risk premium on sterling relative to the euro might have fallen.

14 If, as the Committee had discussed at a previous meeting, there was a positive correlation between the US stock market, corporate sector profitability and investment, and the dollar, then any fall in the US stock market might be associated with a weakening of the dollar. The Committee noted that while there had been a fall in the Dow Jones stock market index recently, the NASDAQ index had continued to rise, reflecting the weight and differential movement of new technology stocks. The difference between the performance of stocks in new and old sectors was striking, and was apparent in the UK and continental European indices too. The Committee also noted the change in the composition of the FTSE 100, which had led to the inclusion of a number of new IT companies.

15 Regarding house prices, both the Halifax and Nationwide indexes showed growth of 15% in the year to February. The latest Royal Institute of Chartered Surveyors survey indicated that the balance of estate agents reporting rising prices remained strongly positive in January. There were tentative signs that the rate of increase in some of the southern regions of the UK might be slowing slightly, offset by a corresponding rise in the rate of increase in other regions. As well as the fall in approvals around the turn of the year, there were also signs that the number of site visits and reservations might be falling. But these indicators might have been affected by the millennium, and it was too early to judge whether activity had in fact slowed. The Committee noted that the rate of

increase in prices would have to slow substantially from current rates over the next two years if the projection in the February *Inflation Report* was to be met.

The labour market

16 There was little news in the data published on labour market quantities this month. The LFS data for employment were likely to be revised up in April, with revisions spread over a number of years. The implications for other data – such as productivity – were not clear.

17 There had been a sharp rise in earnings growth in December. It was interesting that the rise in earnings growth was not restricted to the private service sector, as there had been a marked increase in manufacturing too. There were two main questions. First, how much weight should be placed on the December number in gauging the underlying growth rate? Second, what did it imply about the underlying determinants driving both costs and prices, and also consumption, and hence affecting the outlook for inflation?

18 Some of the marked rise in annual earnings growth in December probably related to bonuses. But because of the change in the ONS's survey form early last year, it was not yet possible to get a clear view on the contribution from bonuses to the change in the annual rate of earnings growth. If it related to bonuses, it would be sensible to smooth the effects. Since it was possible that part of the bonuses related to millennium preparation and working, it was also possible that significant increases in earnings might be recorded for some months to come, and that consequently the annual rate of growth might not decline and even rise in January. One suggestion was that some of the payments might be millennium-related 'loyalty' bonuses, which were negotiated some time ago when companies feared potentially large effects from the Y2K computer problems. If so, these payments might not be directly related to past profits, as in the case of more traditional bonuses, and hence would represent an additional cost to the firm, albeit a one-off cost. In any event, these bonuses would be paid to the household sector, but it was uncertain whether households would consume only the annuity value of the addition to their wealth. Even if they did, 'saving' through purchases of consumer durables would add to aggregate demand. More information would be needed, but taken at face value the latest earnings data were higher than the starting point for earnings growth assumed in the February *Inflation Report*.

19 The contrast between the level of US and UK nominal (and real) earnings growth was quite marked, especially given that recent rapid productivity growth might warrant higher real earnings growth in the United States, and the fact that the millennium effects on pay might have been expected in the US as well. Although UK productivity growth was rising, it was lower than in the US and seemed unlikely to explain the entire rise in earnings growth over recent months. The

increase in UK earnings growth looked less dramatic when an adjustment was made for hours – growth in nominal earnings per hour had been flat, but at a fairly high level of around 5½%, for some time.

20 In contrast to the earnings figures, the three-month AEI-weighted series for pay settlements had fallen slightly over the past month, so the latest settlements data could not account for the rise in earnings growth. The two series implied that there had been a further rise in pay drift, which would be consistent with higher bonuses and/or other factors. This measure of drift had been surprisingly strong over the late 1990s relative to measured productivity growth. Companies continued to report that pay increases were warranted by productivity growth and profits, and that pay deals were often self-financing with unit costs kept in check.

21 There were a number of ways in which to reconcile the apparent contradictions between what individual companies said and what was recorded in the earnings data. First, one possibility continued to be that both aggregate output and productivity were under-recorded. Although this probably had little implication for the output gap as the data for both supply and demand would be affected, there would be lower unit labour costs than currently recorded. However, for this to be significant the under-recording of the level of productivity would have to be increasing through time, which was unproven, but possible in the light of US experience. Second, it was possible that for some companies the falls in input prices over recent years had financed increases in labour costs. In that case, overall costs would rise or drift would fall (to the extent it was profit related) given that input prices were now rising. Another possibility was that a small increase in labour costs in each individual company had only a small effect on its total costs, since labour costs were generally a small fraction of most companies' total inputs. But this could aggregate to a large increase in costs, once intra-firm transactions were netted out and one looked at value added aggregated across the economy as a whole.

Prices and costs

22 The oil price had risen further since the Committee's previous meeting, and had touched \$30 per barrel. It was well above the profile that had been assumed in the February *Inflation Report* projections, though it was possible that it could still come down broadly in line with the forecast path. There was general uncertainty ahead of the next OPEC meeting in March.

23 Manufacturing input prices were volatile from month-to-month, but seemed to be rising by around 10% at an annual rate. Weighted costs in manufacturing (for example, including labour costs, raw materials and other inputs) now seemed to be rising by around 2½% on an annual basis, and at some point might push up output prices unless a further downward squeeze in profit margins

occurred. The current downward pressure on margins might also be leading to an increase in the corporate sector's financial deficit. Forward-looking price indicators of output price pressures – such as the CBI Industrial Trends survey – were still negative.

24 The fall in RPIX inflation to 2.1% in January was also associated with a further fall in HICP inflation to 0.8%, the lowest since the series began and the lowest among all 15 EU countries. A large part of the widening of the wedge between the two series could be explained by differing treatments of housing and of car prices.

25 The CBI Distributive Trades survey balance of prices had recently recorded its lowest level since the survey question began. However, the latest BRC shop price data showed a slight increase in February. Retail goods price inflation continued to fall and was now zero, and there had been a further increase in the rate of decline in the retail sales deflator in January. It was possible that the strong rise in retail sales volumes in January was related to greater discounting. By contrast, the rate of increase of retail services prices had increased to 4.2% in January from 3.9% in December.

26 There was anecdotal evidence that some companies were able to offset some of the rise in input prices by savings made through the use of e-commerce. The recent developments to promote easier and cheaper household access to the Internet might, in the view of some members, lead to quicker and more significant effects from e-commerce than thought likely a month ago. But it was noted that in the US, where there was already low cost access to the Internet by households, the share of retail sales conducted over the Internet was currently only around 0.6%.

The world economy

27 Prospects for activity in the euro area seemed to be improving, and the latest indicators also pointed to slightly higher inflation. But the picture had not changed significantly over the past month. If activity were to strengthen more quickly that might underpin an appreciation of the euro from its current level.

28 The latest US data had again been surprisingly strong. Chairman Greenspan's recent Humphrey-Hawkins testimony, together with the latest data, suggested that there was more concern about the balance of demand relative to potential supply. If this signalled either an earlier and/or a larger move in interest rates than previously expected, then it might increase the chances of a gradual slowing of activity growth. But there were no signs that the testimony had changed market expectations of where US interest rates would go, either in the near-term or further out. It was possible that a further month of strong data had heightened the risks of a bigger change in financial market expectations at some point.

Other forecasts of the UK economy

29 The Committee briefly considered the differences between the February *Inflation Report* projections using market interest rates, and a range of recently published outside forecasts. The main differences seemed to be on inventories and on the price/earnings nexus. On inventories, the MPC's projection assumed a continuing decline in the stock-output ratio. This partly reflected a view that there might be further efficiency gains from the exploitation of information technology. Most other forecasters did not appear to assume a continuation of a downward trend in the stock-output ratio. Differences of view on the cyclical influences on inventories, and the unwinding of any millennium-related adjustments, might account for some of the difference in 2000. There was no simple explanation for the differences that emerged on prices and earnings, which reflected a variety of different judgments. Other forecasts, however, seemed to embody a more benign short term trade-off between growth and inflation. The Committee would return to these issues in the normal course of the quarterly forecast round.

Other considerations

30 The Committee concluded that the timing of the Budget was not a constraint on their decision either this month or next.

31 There had been a widespread expectation that the Committee would not change interest rates this month, although a further rise was still expected by the summer. The Committee agreed that a change in interest rates this month would come as a surprise to the market and would need to be explained carefully. That of itself should not be a constraint on individual members' decisions, but the Committee would need to take into account the prospective effects of any surprise to the markets.

The immediate policy decision

32 A variety of factors were identified which pointed to higher prospective inflation than a month ago, and to which members attached varying weights. First, the underlying pace of demand growth over recent quarters might be even stronger than initially thought, partly because it was against a backdrop of a tighter fiscal position than previously expected for 1999/00. Retail sales volumes in January had also been much stronger than expected and, taken together with some other demand indicators, supported the view that fast demand growth had continued into the first quarter of 2000. In addition, the Committee's projection for domestic demand was below the average of outside forecasts for 2000, albeit largely on account of a highly uncertain contribution from inventories.

Second, the latest data implied a higher starting point for earnings growth than thought at the time of the *Inflation Report*. Third, the oil price had risen further and would, unless it reversed, put further upward pressure on world and domestic prices. In addition, there were significant imbalances in the economy, and these might have implications for aggregate demand and inflation. On net trade, the trend was probably somewhere between the strong Q2/Q3 figures and the weaker Q4 data. Nonetheless, the balance between domestic demand and net trade looked at least as worrying as a month ago. The further deterioration in net trade should at some stage come to an end. But given the upward revisions over the past month to data for consumption and investment in the middle of last year, more might now need to be done to slow the pace of domestic demand growth. A change in asset prices might bring about a re-balancing of the economy. For example, at some point the exchange rate might depreciate, or there could be a fall in the stock market or slower house price inflation. Unless these adjustments occurred, it might be difficult to re-balance the economy. But it was uncertain whether these adjustments would occur smoothly. In the view of some members, that pointed to a greater need to restrain domestic demand growth now.

33 For those members who attached significant weight to these factors, and especially for those whose February central projections for inflation were above target beyond the short-term, there was a case for a further rise in interest rates of 25 basis points. However, there were also reasons for waiting. First, it was possible that after a month some of the fog surrounding some recent data might have cleared. For example, there were tentative signs in some of the housing activity indicators that the market might be turning, although some of the recent weakening might be due to millennium effects. But, given the possibility of stronger bonus-affected earnings data over the next few months, it was not clear that waiting would help to clarify the picture on nominal earnings growth. Second, it was not possible to do a full analysis of the Budget yet, so it might be prudent to wait before drawing a firm conclusion on the implications for inflation. Third, a rise in interest rates this month would come as a surprise to the markets. The market expectation was that interest rates would not move this month, but would still rise by the summer. It was possible that an increase in rates now might be seen as implying a lower path for interest rates in the future. But a rise in interest rates risked pushing up the market's interest rate expectations and hence sterling – which would exacerbate the imbalances in the economy and push inflation further below target in the short run. Overall, the considerations for these members were very finely balanced between raising interest rates by 25 basis points this month and waiting to see more data and analysis. For these members, it was best to keep interest rates unchanged this month.

34 For other members, the recent economic data did not suggest the need to change interest rates this month. Despite attaching some weight to the stronger economic data discussed above, there were data that pointed the other way. Again, different members placed different weights on these various factors. First, although the mix of stronger domestic demand and weaker net trade looked

less benign than a month ago, there were no clear implications for aggregate demand and inflation as these factors were offsetting. Second, the batch of monthly indicators was mixed, and overall it was possible to view them as being mildly weaker rather than mildly stronger for demand and output. For example, some members attached greater weight to the recent weaker industrial production data and the manufacturing CIPS survey, which on this view were consistent with slowing output growth in line with the February central projection. Third, the Budget suggested a tighter fiscal stance than previously anticipated by households and companies. Fourth, there were downside risks to inflation, most notably of a sharp reversal in the recent rise in oil prices or a fall in the US stock market. Fifth, it made sense to wait and try to collect more information on the type and nature of bonuses that were helping to push up average earnings growth. Also, further analysis of the possible differential effects of settlements and drift on prices and consumption was needed. Sixth, a rate rise now, by driving the pound even higher, would aggravate the external imbalance and might increase the probability of a sudden fall in sterling that might thereby jeopardise the inflation target. Seventh, given that interest rates had increased by 100 basis points in four steps over the past six months, it was sensible to wait and see how the economy reacted, particularly, given the short-term profile for inflation.

35 The Governor invited the members of the Committee 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.

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
Willem Buiter
Charles Goodhart
DeAnne Julius
Ian Plenderleith
John Vickers
Sushil Wadhvani

Gus O'Donnell was also present as the Treasury representative.

ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF

A1 This Annex summarises the analysis presented by the Bank staff to the Monetary Policy Committee on 3 March, in advance of its meeting on 8 – 9 March 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 The global economy (except Japan) had remained strong. The Purchasing Managers Indices for the United States, France and particularly Germany had all risen in February. Bank estimates had suggested that quarterly growth in UK export markets for goods and services had been 3.6% in Q3, and 2.4% in Q4. Oil prices had remained strong in February, with evidence of greater backwardation (spot price above futures price). There had been increased volatility in oil prices, reflecting falling oil stocks and speculation about OPEC's strategy. Metal prices had risen in January. Markets were expecting further tightening in monetary policy in the United States and the euro area. Market expectations derived from Fed Funds futures had implied a 27 basis points rise in March and a further 15 basis points in May. Three month euribor futures had implied a rate of 4.1% from June.

A3 Quarterly US GDP growth for 1999 Q4 had been revised up to 1.7%, from 1.4%. Quarterly labour productivity growth in Q4 had been revised up to 1.5%, the highest rate since 1992 Q4. Industrial production and capacity utilisation had both strengthened in January. The value of retail sales had increased by 0.3% in January, following an upwardly revised increase of 1.7% in December. The drop in retail sales growth in January might have reflected a millennium effect. The monthly growth rates of broad and narrow money had fallen back in January, which appeared to confirm Y2K effects. Consumer confidence had fallen in February from its highest ever level in January, probably reflecting rising oil prices and monetary tightening. There had been little evidence of a secondary effect from rising oil prices on price inflation for other goods. The annual increase in the Personal Consumption Expenditure deflator had remained flat in January at 2%.

A4 Preliminary estimates had suggested that GDP had grown in 1999 Q4 by 0.9% and 0.7% in France and Germany respectively. Euro-area industrial production had risen in December. Industrial production in Germany had increased by 0.5% on the month in January. Total manufacturing orders in Germany had fallen by -0.4% in January. There had been a small fall in euro-area employment in 1999 Q3. That was partly explained by the negative effect on German

employment of the unwinding of government job programmes. By contrast, French employment had picked up strongly in Q4. The annual growth rate of euro-area M3 in January had been affected by the impact of the introduction of the euro a year previously. There had been a further increase in both total and intermediate annual PPI inflation in the euro area in December. Euro-area HICP inflation had risen to 2% in January. HICP energy price inflation had risen throughout the euro-area. The sharpest rises had been in Germany, probably due to tax effects.

A5 Official sources had suggested that the first GDP release for 1999 Q4 in Japan might be negative. That was supported by Japanese household expenditure data (published by the Economic Planning Agency), which had fallen by 2.2% in 1999 Q4. By contrast, output data for both industry and services had been flat and consumer confidence had strengthened over the same period. New construction orders had strengthened in January 2000, almost entirely due to growth in private sector orders. The narrowing of the Japanese trade surplus in January had been largely due to the movement in oil prices. Y2K effects on base money in Japan had largely disappeared in February. Both core and headline CPI inflation had remained negative in January (with headline inflation of -0.9%), as had final PPI inflation. Raw materials inflation had increased sharply in January, and there had been a small rise in intermediate PPI inflation.

A6 Industrial production growth in Latin America had strengthened in December. Growth had fallen back slightly in Asia and the transitional economies, though it had remained strong in emerging markets as a whole. Capacity utilisation in South Korea had risen above pre-crisis levels. CPI inflation in December had fallen in Latin America and had remained flat in Asia.

II Monetary and financial conditions

A7 The stock of notes and coin had stabilised in February, following the sharp distortions around the year-end, so longer-term growth rates based on February data could be expected to give a better idea of the underlying picture than those based on either January 2000 or December 1999. The twelve-month growth rate in February had remained strong at 8.4%, in the middle of the 8%-9% range cited for the underlying rate in February's *Inflation Report*.

A8 The stock of M4 had fallen by £2.9 billion (-0.4%) in January taking the twelve-month growth rate to 2.6%, the lowest on record. The fall on the month had been accounted for by a rundown in both households' and private non-financial corporations' (PNFCs') deposits. Other financial corporations' (OFCs') M4 deposits had continued to stabilise after the sharp falls earlier in 1999. OFCs' M4 rose by £1.5 billion (0.8%) in January, taking the twelve-month growth rate from -6.2% to -4.0%.

A9 Aggregate M4 lending (excluding the effects of securitisations) had also been weaker in January, rising by £3.3 billion (0.3%) compared with £8.8 billion in December. The twelve-month rate had fallen by 0.4 percentage points, but remained robust at 8.4%. Much of the weaker outturn in January had been accounted for by a fall in lending to OFCs of £1.1 billion (-0.5%). There had been a £5.8 billion fall in non seasonally adjusted reverse repo activity, consistent with the possibility that the fall in lending to OFCs had reflected an unwinding of banks' millennium-related collateral holdings.

A10 Households' M4 deposits had fallen by £1.5 billion (-0.3%) in January, reducing the twelve-month growth rate to 5.3% from 6.4% in December. Part of the fall in January might have reflected payments delayed from December because of the large number of bank holidays, or millennium-related concerns. Household deposits had probably also been depressed by large payments under the self-assessment tax arrangements.

A11 Households' M4 borrowing (excluding the effects of securitisations) had remained robust, increasing by £4.5 billion (0.8%) in January, with the twelve-month rate at 9.6%. Net total secured lending to individuals had increased by £3.4 billion, down by £0.2 billion from December.

A12 The number and value of mortgage approvals had fallen in January, for the second month running. Both series were now lower than they had been since early 1999, although some lenders had suggested that the fall in January might have been an exaggerated seasonal effect. That was consistent with the pick up in business they had seen in February.

A13 Provisional estimates by Bank staff had suggested that mortgage equity withdrawal had remained strong in 1999 Q4 at around £3 billion, though somewhat lower than in Q3. On this basis, total real lending for consumption (real mortgage equity withdrawal plus real unsecured lending) was estimated to have been higher in the second half of 1999 than at any time since 1990.

A14 Bank borrowing by PNFCs minus PNFCs' M4 deposits had risen again in January, through lower deposits rather than higher lending. PNFCs' M4 deposits had decreased by £2.8 billion in January; PNFCs' M4 lending (excluding the effects of securitisations) had fallen by £0.1 billion. Non-bank borrowing by PNFCs had also been relatively strong in the first two months of the year. Strong net borrowing in recent months had been consistent with higher corporate expenditure relative to internal funds.

A15 Since the previous MPC meeting, interest rate expectations about the immediate future as measured by the gilt repo curve had remained unchanged, but expectations at longer maturities had fallen by around 40 basis points. Over the month, long-term UK yields had moved particularly closely with US bonds. UK corporate bond yields had fallen in line with gilt yields providing continued incentives for companies to issue debt. The February rate rise had been fully passed through to the average standard variable mortgage rate, but there had been a continued trend for lenders to provide greater discounts for new mortgages.

A16 A fall in real forward interest rates derived from the yield curve had accounted for the fall in nominal forward rates at the long end. At shorter maturities the fall in nominal forward rates had been attributed to a fall in inflation expectations. Survey-based measures of inflation expectations for the next couple of years had remained below 2.5%.

A17 The FTSE All-Share index had risen by 3.2% since the previous MPC meeting, while the FTSE Small Cap index had risen by 10.6%. Since October 1999, the FTSE IT sector had more than doubled in value.

A18 Since the previous MPC meeting, sterling had appreciated by 1.6% against the euro, but depreciated by 1.7% against the dollar and by 3.8% against the yen. The sterling effective exchange rate index (ERI) had appreciated by 0.6% over the same period. Monetary news had been unable to explain bilateral exchange rate movements. The sterling ERI was 0.1% below the February *Inflation Report's* modal projection.

III Demand and output

A19 Quarterly GDP growth at constant market prices had been unrevised at 0.8% in 1999 Q4, though the annual growth rate had been revised up to 2.9% from 2.7%. Quarterly growth in 1999 Q3 had been revised up to 1.0% from 0.8%. Total industrial production had risen by 0.1% in 1999 Q4. Manufacturing output had grown by 0.5% in 1999 Q4, while service sector output had grown by 0.9%, unrevised from the preliminary estimate. Construction output had grown by 0.7% and agriculture had grown by an unusually strong 1.2%.

A20 The National Institute of Economic and Social Research had estimated that the three-month on three-month GDP growth rate had been 0.8% in February.

A21 The expenditure breakdown of GDP showed that domestic demand had grown by 1.9% in Q4. Final domestic demand had grown by only 0.9%, however, as the change in inventories had contributed 1.0 percentage points to quarterly growth.

A22 Private consumption (including that of non-profit institutions serving households) had grown by 0.8% in 1999 Q4. Private consumption had grown by 4.4% in the year to 1999 Q4, the highest growth rate since 1989 Q2. There had been significant upward revisions to consumption growth in the first half of 1999. This had reflected new data on alcohol spending: the level of consumption in 1999 Q3 was 0.5% higher than had previously been thought. A complete breakdown of consumption for Q4 was not yet available. Government consumption had risen by 0.7% in Q4, unchanged from Q3. Total investment (including acquisitions less disposals of valuables) had grown by 1.7% in 1999 Q4. There had been significant revisions to investment growth in 1999: the revised level of total investment in 1999 Q3 was 1.1% higher than had previously been thought. Business investment had risen by 1.2% in Q4, and was 3.8% higher than a year earlier. Within this, manufacturing investment had fallen by 2.9% in Q4, while service sector investment had risen by 3.0%. Total company profits had fallen by 0.3% in Q4, but were 8.0% higher than a year earlier, and corporation tax data had also suggested that company profits had improved.

A23 Inventories had made a positive contribution to GDP growth in 1999 Q4. Including the alignment adjustment, inventories had risen by £0.6 billion in Q4, compared with a fall of £1.3 billion in Q3. The CBI Monthly Trends survey in February had reported that manufacturers still perceived their stocks to be more than adequate, though the balance was below the long-run average. Other surveys had pointed to a drawing down of stocks since the new year.

A24 Net trade had contributed -1.2 percentage points to GDP growth in 1999 Q4, the first negative quarterly contribution since 1999 Q1. Total exports of goods and services had fallen by 1.6%, while imports had grown by 1.8%. Exports of goods to non-EU countries had fallen by 5.4% in Q4, partly reversing the increase in Q3.

A25 Turning to indicators of Q1 activity, manufacturing output had fallen by 0.4% in January. Retail sales volumes had risen by 1.5% in January, consistent with the British Retail Consortium (BRC) survey. Growth in retail sales volumes had continued to exceed that of retail sales values. The CBI Distributive Trades survey had shown a total balance of +47 retailing respondents reporting higher sales in February compared with a year ago, up from +29 in January, and further growth had been expected in March. The MORI measure of consumer confidence had fallen sharply to -10 in February and the GfK confidence index (which had a bigger sample and had historically been less volatile) had fallen a little to +3.1, though confidence about households' own situation remained firm. Private new car registrations in the three months to February had fallen by 12.4% on a year earlier. Total new registrations had fallen by 5.2% over the same period.

A26 The housing data had been mixed in February. The Halifax house price index had fallen by 0.9%, but the Nationwide measure had risen by 2.2%. Annual house price inflation had remained high at 15.0% on both measures. Particulars delivered had increased by 5.4% in January and the annual growth rate had risen to 20.4%. Private housing starts and completions had both risen in January.

A27 The public sector net cash requirement had been -£17.2 billion in January (a surplus).

A28 Turning to the latest sectoral surveys, the manufacturing output expectations balance in the CBI Monthly Trends survey had remained broadly unchanged at +10 in February. The total orders balance had increased to -11 in February, and the export orders balance had increased to -25

A29 The headline index of the Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey had fallen further to 51.0 in February. The output index had fallen to 52.1. Stocks of finished goods had fallen in February for the fourth consecutive month. The survey had pointed to rather more buoyant export growth than the official data had suggested in recent months. The latest DHL survey had shown a strengthening in exporters' confidence. The headline CIPS services survey balance had risen slightly to 57.3 in February, the twelfth successive month of expansion. The CIPS construction index had also been strong, rising to 62.0 in February. Construction new orders had fallen by 3.9% in the three months to January compared with the previous three months, and were 3.1% below their level a year ago.

IV The labour market

A30 Labour Force Survey (LFS) employment had increased by 75,000 (0.3%) in 1999 Q4. The rate of growth had been slower than in Q3, but slightly higher than in the three months to November. The increase had been largely accounted for by a 60,000 (0.3%) rise in full-time employment; part-time employment had risen by 14,000 (0.2%). Employment in full-time equivalent terms had risen broadly in line with heads. The total number of hours worked had risen by 0.2% in Q4, though average hours worked per person had fallen by 0.2%.

A31 Turning to survey data, the CIPS manufacturing survey for February had suggested that there had been a further fall in manufacturing employment, but at a slower rate than in January. The same survey had suggested that construction employment had expanded at a more rapid rate than in January, while services employment growth had remained stable.

A32 New vacancies notified to Jobcentres had fallen by 7,700 in January, to 228,800. The Recruitment and Employment Confederation (REC) survey for February had suggested that there had been a further decline in the availability of agency staff. The latest reports by the Bank's regional Agents had suggested that skill shortages persisted.

A33 LFS unemployment had fallen by 4,000 in Q4, though the rate had remained unchanged at 5.9%. Claimant count unemployment had fallen by 44,700 in Q4, and by a further 9,800 in January. The claimant count rate had fallen in January, to 4.0%.

A34 Labour market inactivity had fallen by 36,000 in Q4. The percentage of the working-age inactive wanting a job had remained broadly unchanged.

A35 Whole-economy headline earnings growth, a three-month moving average of the annual monthly rates, had increased by 0.6 percentage points in December, to 5.5%. This increase had been accounted for by a rise in private sector headline earnings growth; public sector headline earnings growth had remained unchanged. Headline earnings growth in both manufacturing and services had increased by 0.5 percentage points, to 5.0% and 5.7% respectively. The twelve-month growth rate of whole-economy earnings had risen by 1.1 percentage points to 6.2%. The ONS had suggested that about half of the increase in this month's (non seasonally adjusted) Average Earnings Index (AEI) growth rate was accounted for by the financial services sector, mainly reflecting larger bonus payments than a year ago.

A36 Other earnings data had offered a mixed picture. The February REC survey had indicated a rise in earnings growth for both permanent and temporary staff supplied by job agencies. The Reward index had fallen from 3.4% in December to 3.2% in January.

A37 The Government had announced that the National Minimum Wage was to be uprated in October 2000. The adult rate was to be raised from £3.60 to £3.70. The youth rate was to be raised from £3.00 to £3.20 in June.

A38 The Bank's AEI-weighted twelve-month mean measure of whole-economy settlements had been unchanged in January, at 3.4%. The three-month whole-economy mean had fallen by 0.4 percentage points to 2.4% in January, though this was based on comparatively few new settlements.

A39 Details of the settlements for both Armed Forces staff and senior public sector workers had been announced. Overall, the paybill of both groups was to increase by 3.3%. Both increases would come into effect on 1 April.

V Prices

A40 The Bank oil-inclusive commodity price index had fallen by 0.6% in January, taking the annual inflation rate from 21.4% down to 18.4%. The monthly fall had reflected price falls in all the major components of the index, except for metals. In particular, the price of domestic food had fallen quite sharply, suggesting that domestic food prices had not yet reached their trough. Excluding oil, commodity prices had fallen by 1.0% in January to give an annual inflation rate of 1.2%.

A41 Manufacturing input prices had fallen by 1.0% in January, taking the annual inflation rate from 12.2% to 10.4%. This had mainly reflected falls in the prices of domestic food and of imported materials. January's fall may have been only a temporary pause in the recent upward trend in input prices, however, as oil prices had risen sharply again in February. According to February's CIPS manufacturing survey, the input price index had risen to its highest level since August 1995. Total output prices excluding excise duties (PPIY) had remained unchanged in January, to give an annual inflation rate of 1.8%, slightly up from 1.6% in the previous month. February's CBI survey output price balance had also remained unchanged at -4, with respondents having continued to report expectations of falling prices.

A42 Imported goods price inflation had been broadly unchanged at -0.4% in December, despite a further rise in the contribution from fuels prices to 1.9 percentage points. The contribution from manufactured goods prices had fallen further to -1.8 percentage points from -1.4 percentage points. Total goods export price inflation had risen to 2.6% in December, with a larger positive contribution from fuels prices.

A43 RPIX inflation had fallen to 2.1% in January, down from 2.2% in each of the previous three months. HICP inflation had fallen to 0.8% in January, the lowest since the series began in January 1996 and also the lowest in the EU. The difference between HICP and RPIX inflation had widened to 1.3% in January from 1.0% in the previous month. Around 40% of this change in the wedge had been accounted for by higher housing depreciation which is not included in the HICP measure.

A44 The gap between RPIX services and RPIX goods price inflation had widened to its highest level since November 1991. RPIX service price inflation had risen to 4.2% in January. The largest positive contributions had come from leisure (0.3 percentage points) and vehicle insurance. RPIX goods price inflation had fallen to 0.0%, the lowest on record. The largest positive contributions to RPIX goods price inflation had come from petrol (0.7 percentage points)

and tobacco. The BRC Shop Price Index had risen by 0.9% in February, to give an annual inflation rate of -0.3%. The CBI Distributive Trades Survey retail price expectations balance had fallen to -9 in March, the lowest since the series began in 1983.

VI Reports by the Bank's Agents

A45 The Bank's regional Agents had reported a pause in manufacturing output growth as millennium stocks had been run down. There had been stronger growth in business services mainly related to professional services. Consistent with the latest CIPS construction survey, construction orders had continued to grow, particularly from the leisure industry and projects under the Private Finance Initiative.

A46 Some Agents had reported a slight easing in retail sales growth since January as many retailers had run down stocks, though the household goods sector had continued to show strong growth. The new car market had remained subdued, but there had been reports of continued recovery in the used car market. Exporters had remained confident about the strength of overseas demand growth, but margins had been further squeezed owing to the strength of sterling. There had been evidence that import penetration had increased, both at the intermediate and final production levels.

A47 In the housing market, prices were reported to be rising, but not accelerating. There had been some evidence that activity had peaked, with the exception of city centre sites. In the labour market, skill shortages had remained a concern. There had been considerable variation in December bonuses across and within both regions and sectors.

A48 Manufacturers' input prices had continued to rise. There had been continued downward pressure on manufacturers' output prices, squeezing margins further. In the service sector, input price increases and higher wage costs had remained easier to pass through to consumers.

A49 Retail price inflation had been reported to have been broadly negative, and the Agents had reported some concern from their contacts about higher overhead costs.

A50 The Bank's regional Agents had conducted a survey of UK firms regarding their investment intentions. Among the contacts sampled, more companies had raised their investment plans than had cut them over the past six months. The construction and non-retail services sectors had recorded the strongest revisions to their investment intentions. Over the next two years, the majority of firms had expected investment spending on IT to be maintained or increased, compared with the previous two years. Almost half of the companies surveyed had claimed not to

have made any significant borrowing in the past six months. But of those companies that had borrowed, financing new domestic investment had been by far the strongest motive.

VII Market intelligence

A51 Expectations of UK interest rates implied by short sterling futures had fallen since the MPC meeting, by around 30 basis points for contracts maturing in 2001 and 2002. Expectations of interest rates in the United States and, to a lesser extent, the euro area had also fallen, notwithstanding expectations of increases in official rates in March by the FOMC and ECB. By contrast, there had been little expectation in the market that official rates in the United Kingdom would rise in March. Market participants had commented on the disinflationary effects of a high exchange rate and the possibility that the earnings and retail sales data had been distorted by end-year effects.

A52 Sterling's effective exchange rate had appreciated slightly since the previous MPC meeting, with a 1.6% appreciation against the euro (which has a 65% weight in sterling's effective exchange rate) counterbalanced by a depreciation against the dollar. In seeking to explain the continued strength of sterling, market participants had emphasised the impact of the general weakness of the euro. Against the dollar, sterling had been at the bottom of its trading range over the last three years. Risk reversals traded in the foreign exchange options market had suggested that market participants had been paying a premium to protect themselves against the risk of sterling depreciating against the dollar. This was not the case against the euro. Data on market positioning had suggested that most participants' holdings of sterling were close to their benchmarks. Chart-based traders had continued to expect the euro to depreciate against sterling.