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A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 18 JULY 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Sir Brian Moffat
Mr Morris
Mr Stretton

Absent:

Dame Sheila McKechnie
Mr Neill
Ms O'Donovan
Sir Neville Simms

The Governor welcomed Sir John Bond to his first meeting of Court.

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

MONETARY STABILITY ISSUES
Economic and monetary discussion, incorporating the monthly MPC report to Court (Ms Barker, Professor Nickell and Messrs Allsopp, Bean, Clark and Plenderleith in attendance)

In introducing the monthly MPC report to Court, Mr Bean said that looking at the international picture, US growth was still weak and the industrial production figures for June had fallen, for the ninth month in a row. In general, developments in the US over the last month or two were in line with MPC expectations and with outside forecasters. The expectation was of a slight

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recovery towards the year end and into next year. He noted that the news was not particularly good from Japan and emerging markets, which had been hit by the US slowdown. Korea in particular was suffering. But the key news was weak demand in the euro area, which appeared to be slowing more markedly than expected. It was notable that the slowdown was partly domestically generated with growth in the first quarter almost entirely down to net trade. This was particularly evident in Germany. The picture was of a euro-area experiencing negative effects from the US that were being compounded by domestic forces. Business confidence was declining and consumer confidence, which had stayed up, was starting to tone down a little. The deterioration in the prospects for the euro area was troubling. He noted that world inflationary pressures continued to be subdued. The dollar and sterling were strong and the exchange rate index was up 1% since the May Inflation Report. However, against the dollar sterling had been relatively weak.

Turning to demand in the UK, Mr Bean said the official data for consumption was surprisingly weak in the first quarter, but retail sales, credit and house prices were strong, and consumer confidence was fairly steady. Investment in contrast was weak, according to the official data for the first quarter, after a relatively large increase in the fourth quarter of 2000, but it was not clear whether this was an erratic movement. Investment was still high as a share of GDP. He noted that Government spending was set to grow above trend. The trade deficit was widening. The overall picture was of continued reasonably robust growth in final domestic demand but, given that activity was slowing, the implication was a widening trade deficit.

Turning to activity, Mr Bean said that June manufacturing and industrial output were both down, and the fall was again partly due to hi-tech sectors, including electrical and optical engineering. Manufacturing orders were weak but stable. The CIPS survey suggested unchanged services growth. He noted the tensions implied by the trade deficit. It was now 2% of GDP. Historically that level might be sustainable, but once the deficit neared to 5% something nasty tended to happen. The problem the MPC had to grapple with was how to deal with these imbalances.

Turning to the labour market, Mr Bean noted that employment growth had slowed which could help to cool consumption, though the latest data released just before Court showed employment had continued to grow. Unemployment continued to fall; the latest data showed a small fall in the claimant count in June to 3.2%. Underlying earnings growth was up, and regular pay was up 5.3% in the year to April, largely due to the public sector. Blips from month-to-month were not surprising.

Turning to prices, he noted that RPIX inflation remained at 2.4% in June, which was higher than expected. This was mainly due to seasonal food prices such as potatoes, Foot and Mouth disease and bad weather. A good part of the increase was temporary, but there was some evidence of an underlying tick-up in the retail price index, though this was nothing to get too worried about. RPIX inflation had risen by 0.6 percentage points since January while RPIX inflation excluding food, had risen by 0.2 percentage points. Mr Bean also noted that the July vote of the MPC was 8-1 in favour of no change, with Dr Wadhwani voting for a reduction of 0.25%.

Mr Plenderleith said that there had been very little change in recent weeks in the main markets. Sterling had traded in a narrow range but this did not imply that it was particularly stable at the moment. There was a sense that the market was waiting on events, particularly the world economy and its impact on the UK. The same was true in other markets where there had not been much movement, but there was a sense of underlying tension. It was possible that there could be adjustments in pretty well any direction depending on the course of events. There had been more movements in emerging markets. He drew Court's attention to chart 8 . There was a widening of bond spreads in Argentina and in some other emerging markets but it was not universal. In Asia the impact had as much to do with the world economy as any contagion from Argentina.

In response to an invitation from the Governor to the external members of the MPC,
Mr Allsopp said he would like to reinforce the question posed by Mr Bean. The MPC was trying to understand whether the consumer would continue to spend or draw in horns.
Mr Bailie noted that TV advertising nationally was down 20% in June and tourism was still suffering. Printing and packaging was still struggling as it had been for two years. Northern Ireland was doing quite well though confidence was subdued. However the view was that the worst might be over. There was a little light at the end of the tunnel. People were expecting the second half to be better than the first half. Ms Blow noted the size of the service industry and the point made about its growth being unchanged. The IT services sector was still falling

and growth had been gradually slipping to less than 10%. She also said that she had attended the pre-MPC and noted the difficulty of acquiring data and interpreting the results at a time when the world was more difficult to read. Mr Bean agreed that services data generally was less good than manufacturing data. Also, when the structure of the economy was evolving, with new service industries, it took time for the official data to reflect that. Mr Morris said that talk of a two speed economy was to some extent coming back. Manufacturing, he suspected, was performing even worse than before because it was now suffering both from a high exchange rate and a significant fall in demand. Margins were becoming tighter and tighter. At some point perception and reality would come together dramatically. Dr Julius noted that she had been talking the day before to the air transport industry. This was only the third year since the war that there would be a fall in overall traffic volume world wide. The fall in bookings was not just at the other end of the route, but at the UK end of the route. There had been down grading from business to economy class.

Mr Hall said the data provided by the Bank was tremendous and the regional reports were excellent. He noted the point about two speed economy, which had a regional dimension. In the north, there was more exposure to traditional manufacturing and to mass production for hi-tech products. House price inflation was very much less in the north. The two speed economy exaggerated the differences in prosperity between the north and the south and within a region; for example, Leeds was more prosperous than other parts of its region. Sir David Cooksey noted that where sales had taken place in June last year they had moved this year into the first week in July, so there could be an artificial dip in the June retail sales figures. Sir Howard Davies noted that the CBI PricewaterhouseCoopers survey suggested that confidence had been restored in the financial sector and there was some other evidence of that. He noted the wholesale market shakeout was causing banks to consolidate and lose staff, and this was in relative terms benefiting London. For example, a French bank had the day before announced it was consolidating all its reduced emerging market trading in one place, London. There were a number of examples of that. The equity markets tone was extremely weak, and it was an environment in which good news left the market flat and bad news pushed it down. One difference from previous episodes was that in the retail sector many people held their savings in more transparent instruments, where the impact of falling markets was seen more quickly. He noted the reduction of 16% in the value of funds at Equitable Life and said that someone with a pension in a PEP would have lost 20% in the last 12 months. People received statements for their last 12 months investment performance which showed in a starker form than a decade ago the fall in their assets. He noted that it was difficult to say at this stage how that would come through into spending - but it would be more transparent.

Sir Ian Gibson said that the automobile industry saw the US as having bottomed out but not come off the bottom. No further decline was expected. Germany continued to decline and there was no sign of that stopping. The manufacturing story was bleak this year and next. In the UK, a lot of dealers disappeared last year but those left were back to, and above, earlier profit levels, which was healthy for the sector, and reflected the consumer trend that had been mentioned. June showed year-on-year growth in sales, but July was not so good for the first ten days, though he noted that a partial month's figures were not necessarily reliable. Dealers were still optimistic about September, and given the annual pattern of sales, if that were right, it would be a good year. Mrs Francis said she would like to echo the points put by Sir Howard Davies on the effects of the equity markets. There was an unfortunate but predictable conjunction of a downturn and some specific company failures. There was likely to be consolidation in the retail insurance sector as well as the wholesale because of the need for substantial reserves to back retail companies operations. There was also a rather open question - if there was a fall in consumer confidence and equity savings, would people put their money into Building Societies or spend it? The effects of lack of confidence were not at all clear. Turning to the Agents' report, she asked whether it would be useful to ask companies about their experience of infrastructure in their areas. It could be an indication of when times would get better.

FINANCIAL STABILITY ISSUES
Domestic developments and international issues
(Messrs Bean, Clark and Plenderleith in attendance)

Mr Clark said that over the previous month there had been a marked deterioration, particularly in Argentina and Turkey, but also slightly more broadly than that, with the result that the average spread on emerging market debt had risen 130 basis points, and the equity markets in these countries as a group had fallen 10% in dollar terms, partly because of the exchange rate and partly because of domestic problems. He noted that signs of contagion had been rather weak, at least until 10 days ago, when it appeared that some spillover was beginning to happen. However, in contrast to 1998, it appeared to be a rather short lived effect and in the last few

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days some of those spillovers had subsided a little. After describing the situations in Argentina and Turkey, he noted that there were common features in both cases, related to concern about the sustainability and arithmetic of the debt dynamics and the political deliverability of fiscal restraint. Unless interest rates in Turkey came down quite dramatically there would be an explosive growth in debt. Rates were 40 percentage points higher than the IMF envisaged at the time of the restructuring. Another matter common to both was whether they had the political capacity to deliver the change. As for the wider impact, the exposure of these countries on their own was not life threatening to financial institutions. There were concentrations of exposure, in Germany to Turkey and in Spain to Argentina. If there were a significant write down on Argentine external debt of $130 bn it would have a significant effect on some of these banks. He noted that the transfer of credit risk associated with Argentine debt had been one of the most active parts of the credit risk transfer market and a lot of this risk had moved to European insurance companies. In one sense dispersion made it easier to handle, but it depended on who wound up with the risk. He noted that the world economic background was uncertain and could exacerbate the difficulties, and the Bank would be keeping a very close eye on these two countries. The contagion effects in Eastern Europe, Russia and elsewhere seemed to have ameliorated for the time being, but they could reappear if there were worries about Turkey, Argentina or both.

Turning to Basel, he noted that at the end of June it had been announced that the timetable for completion of discussion and implementation would be delayed for a year. There were still major questions about the overall capital levels the arrangements would deliver, and also about the cyclical impact of the way capital requirements were determined.

Mr Clark noted that the European Securities Forum under Pen Kent had made efforts for the last 18 months towards consolidation of European market infrastructure. There were press reports that this had not proved successful so far. Mr Kent had been concerned for some time that matters were not moving forward. There were however other initiatives in play. These developments illustrated how difficult it was to bring about some of the alliances that two years ago people had thought would happen quite quickly.

Sir John Bond said that he had recently discussed these issues with some of the top risk managers in US banks, who had said that the easiest place to place credit risk was with

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insurance companies. He also noted that HSBC was probably the biggest distributor of dollar bills on behalf of the US Federal Reserve and it had been unable to supply the demand in Argentina at the rate the market wanted. He noted that banks there were facing a liquidity squeeze, and HSBC was bracing itself for some form of partial default, notwithstanding the efforts of Mr Cavallo.

Sir Howard Davies said he agreed. It was hard to see how Argentina could get out of its problems without some kind of default or losing its dollar peg. From the London point of view exposure to Argentina among emerging markets was the largest after Singapore and Hong Kong, at just less than $7 bn. That was not trivial, but not a market threatening amount. There was only one Argentine bank taking deposits in London, and that was small. All Argentine and Turkish financial institutions were reporting liquidity daily to the Financial Services Authority. There were no particular signs that exposures in London would cause serious difficulties. He noted that Mexico was not particularly affected, and he noted that the currencies of Chile and Brazil were at their lowest ever levels. The Brazilian central bank Governor had gone to New York to talk to banks ahead of a holiday, and had been told by the banks to go back and mind the shop. There were nerves in the market about Brazil which could become quite serious if they spread.

Mr King commented that there had been a great deal of excitement and nervousness about Argentina, but the immediate urgency had reduced. He noted that the political cost of partial default or abandonment of the currency board was extremely high. When a crisis looked as if it was going to happen politicians would start doing things that they would not do before, and that was what had occurred over the previous weekend, for example with the salary cuts for public servants. He guessed that there would be several rounds more of such decisions before Argentina got to a final position. It was very hard to see the outcome. The issues could develop so quickly that they got out of control so that the measures agreed would not be enough to contain them. It would drag on quite a long time. Against a background in which the cost of abandoning the Currency Board was so high, there might well be agreement on the fiscal and other fronts to buy more time. The other thing that was encouraging was that Argentina had not applied for more money from the international community and there had been no encouragement to do so from the United States. Under the previous administration there might well have been crisis talks now in Washington about a new package deal for Argentina. The

Argentine Government knew the current position and accepted it was their responsibility to do something about it. An application for a package of financial help might even trigger a financial crisis at this stage. The problem could continue for quite a while for these two reasons.

The Governor commented that there had been a sense in the past that if the price for stabilisation looked too high then the country would be baled out. He believed there was a greater sense now of the dangers of that. Argentina had to address the issues, not look to the international community to bail it out. It was interesting, given that, that contagion was relatively limited. He interpreted that as meaning that markets were coming to terms with the idea that was a limit to the amount of international support. Mr Stretton asked about the relationship between the Bank's financial stability role and the regulatory relationship with the insurance industry.

The level of interest in risk was of a different order for banks than for insurance companies. He believed that this was a subject for discussion between the Bank, with its interest at the macro level, and regulators. The Governor said that in the context of the Bank's interest in the stability of the system as a whole, banking loomed larger than insurance because it had liquid liabilities and less liquid assets, bringing contagion risks to the payment system and direct exposures. The Bank had a general interest in insurance but not as direct as its interest in banking. If it believed Equitable Life to be typical of the insurance industry that would loom larger, but for the time being that was not the Bank's perception. Mr Stretton said he understood that point but if areas of concern were identified about how risks transferred through the system then conversation should take place about how to minimise those risks. Mr Clark said that such discussions took place. He noted that there had been a long piece on credit risk transfer that covered this issue in the Financial Stability Review. The Governor noted that this was not about insurance companies but about the impact on banks if they failed. Sir Howard Davies noted that the forum in which such discussions took place was of tripartite type standing committee, attended by Mr Clementi and Mr Clark, Mr Foot and Treasury representatives, and it had been addressing this question of risk transfer and the stability of the insurance industry. The Governor said that the general point about risk transfer was something that the Bank had been pointing out in various ways, including in the FSR.

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FINANCIAL MARKET OPERATIONS ISSUES
Current Issues
(Messrs Bean, Clark and Plenderleith in attendance)

Mr Plenderleith, noting that he had explained to Court the previous month about the introduction of an overnight deposit facility, reported that that had been done and it was in place and working well for its limited purpose. He also noted that the 13th gold auction had taken place. There had been some apprehension because the auction in July 2000 did not go well, but this one went extremely well. It was four times covered and the price was slightly more than the market price at the time, and the market price had since firmed. The National Audit Office, in investigating how effectively the Bank had conducted the programme, had reported in a rather complimentary fashion. He had been called to the Public Accounts Committee with the Treasury to give evidence and this was reasonably straight forward and he had been waiting to see the PAC report. Following the election a new PAC was being set up and it was not clear that they would issue a report.

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

[redacted]

[redacted]

The Governor noted that it was Governor's Day on the following Sunday and Members of Court who attended would be warmly welcomed.

The Governor noted that Court on 15 August would start later than usual, at 11.30am.

The Governor noted that the question of a review of the forecast process had been raised. The previous Thursday the House of Lords debated the Select Committee Report on the MPC, which had been produced earlier in the year. One of the Report's recommendations was that a review of the method of forecasting inflation used by the MPC should take place, with a view to discerning whether it was state of the art. In the debate the previous week, Lord Peston, Chairman of the House of Lords Economic Affairs Committee, said that the next time the House debated economic matters, he hoped to be able to report on the actions the Bank had taken in this respect. The Governor noted that in Court folders was a paper addressing the issue, prepared by Mr Bean. He invited Mr King to comment first.

Mr King said that this was part of the review of MPC procedures. It had been thought that there would be occasional independent reviews of some aspects of procedures following the Kohn Report, perhaps every three years. The House of Lords Select Committee accelerated the idea of commissioning a second report. It was proposed that a review of the method of forecasting inflation should take place with a view to deciding whether it was state of the art. It should be sponsored and financed by Court, though Court should not undertake it. The Bank had agreed to explore this. There would be some overlap with the Kohn Report, which looked at the purposes of forecasting and the link between the forecast and the policy decision, the ownership of the forecast and the difficulties of producing a forecast with a committee. The Bank's understanding of the House of Lords recommendation and its own view of the new review was that it should not cover this ground again. It should focus instead on the technical quality of the forecast expertise made available to the MPC, and whether it was state of the art. He and Mr Bean had thought of names to carry out the work. Mr Bean's paper was very much concerned with the names of the runners and riders. The Bank was at a stage where to take this forward it needed to agree who should do it.

Mr Bean said it was quite difficult to find people with exactly the right balance of skills. The person concerned needed to be technically qualified and credible in the eyes of the outside world, but in terms of getting the maximum out of the review it was desirable that that person had practical experience in the use of models in policy and analysis. He noted that there were quite strong differences of view among academic experts about forecasting methodology. It was particularly important to avoid picking someone associated with a particular methodology who might push it. It would be better to pick names that would take a reasonably catholic and pragmatic approach. A list of twenty names had been drawn up which had been reduced to five, among which the best was Adrian Pagan. The paper described his qualifications and also those of [redacted]

The Governor said that if Court were content the Bank would like to explore the practicalities with Mr Pagan. Dr Julius said that she was sorry that Court had not seen the paper in advance. This was one of the most important activities that Court undertook. She would like Court to see the terms of reference of the review. It was not right to separate the process from the methodology, because the two were related. It would be wrong to limit it to the technical aspects. Kohn had looked at the forecast process within a wider remit and concluded that there was no perfect forecasting process and he did not plump for a particular one. He recommended that the issues should be kept under review. The terms of reference should include the process as it related to the forecast methodology. There were structural differences between the Bank of England and other central banks that made it harder to agree a single forecast. The terms of reference should be seen by Court before a person was selected to carry out work. Turning to the question of the person, she agreed that technical expertise and practical experience would be required. She would give more weight to the practical experience side. She was reluctant to think that with the best possible theoretical and technical forecast the MPC would get as good a result as looking at the best forecast for the particular structure of the MPC. It was also hard to believe that the MPC would throw away what it was doing if an outside expert recommended that it should do something differently. It was important to have a reviewer who would look at the possible benefits on the process side and how that matched the methodology. She would look at a longer list of people, and would include David Hendry. It was worth considering Sir Alan Budd, Professor Charles Goodhart - though he was on record as favouring a particular approach - and Alec Chrystal.

Mr Hall said he would like to see how accurate the MPC forecast had been. It could then go back to the House of Lords, if the answer was good, and say there was no need for the outside assessment. He also asked whether there was a central benchmarking expertise that could give inter - Central Bank comparisons. He also said that, if the work went ahead, Court should see the cost and the timetable, and he also asked whether an organisation with more than one individual might be appropriate to do it. Mr Morris said it was important that Court sought to identify the owners of the forecast. There was some confusion about whether it was the MPC's or the Bank's forecast, and that undervalued the document. The Governor said there was confusion, but this was a communications problem which the Bank was seeking to address. The exercise was not intended for that purpose. He took it from Dr Julius that the Bank needed to come back to Court with the terms of reference before going further. The Bank could also pick up some of the points about other possible people.

Sir David Cooksey noted that when he and Baroness Noakes had talked with people in and out of the Bank, before the Annual Report, there were very diverse views about how much the Bank should be investing in increasing modelling capacity. Knowing the sort of people who might respond to a report, it was important that the report took an agnostic view. Mr Bean noted that Dr Julius had mentioned Professor Hendry who had been on the list of twenty, but he had a very particular view about how forecasting should be done, which was why it had been thought that he was not the best to do the work. It was necessary to find someone reasonably even handed and pragmatic, but technically on top of the various approaches. He noted Dr Julius' suggestion of employing someone connected to the Bank, where there would be advantages because they would know how the Bank operated. But there was a problem in the public dimension, which was that outsiders would not see it as sufficiently independent. This would be a problem with Professor Goodhart or Sir Alan Budd, who in other respects would be ideal. Mr Bailie noted the risk of employing people with pre-conceived ideas. He also noted that the Report could be damned the day it was published if it did not match the views of certain academics. He thought there were advantages in having more than one person do the exercise. The Governor said this was not an easy question. It could perhaps be considered too. His view was that it would be a terribly difficult exercise to do by committee.

Dr Julius, returning to the terms of reference, said that it might be most useful to the MPC if a report came up with several options for improvement in different directions, which the MPC might come back to and consider and respond to publicly. Another way would be to ask the person or committee writing the report to develop or propose two or three options that would have net benefits over what was presently done. The decision on whether to follow any of these would be for the MPC. The Governor said these issues could be tackled in the terms of reference. He noted that the Kohn Report had covered the five options of ownership. The terms of reference of the new report could cover the more technical aspects of forecasting. Sir Brian Moffat said that when this emerged, Court would be asked whether it had a view. It should also be careful that it did not become managed by the Lords. This would not be appropriate in governance terms. The Governor said he did not wish to leave the impression that it was imposed on the MPC, or on him as Governor. The Bank felt it would be beneficial to have an outside eye looking at the technical questions. Mr King agreed with Sir Brian that Court had to form a judgement on whether the material and procedures of the MPC were state of the art. Court would be called on to form that judgement. That was a responsibility under the Act. Court was not there to go over the Kohn ground again or to second guess the Committee. But it should say whether, given that the MPC made a forecast as a Committee, it believed the best technical advice and support was available. Sir David Cooksey noted that about two years ago Court had said that the right thing to do would be to review the quality of the forecast against outcomes.

The Governor said that the Bank would come back to Court with the terms of reference and have further discussions to try to identify the appropriate individuals.

MANAGEMENT OF THE BANK
Quarterly Financial Report
(Messrs Bean, Clark, Plenderleith and Midgley in attendance)

In introducing the Quarterly Financial Report for the first quarter of the Bank financial year, Mr Midgley said that, as usual at the time of year, expenditure was below budget; one factor in this was the pattern of expenditure at the Printing Works, which fell unevenly through the year. He also drew attention to the increasing legal fees in respect of the BCCI defence.

Mr Hall noted that the damages claimed against the Bank by the BCCI liquidators was for £550mn and asked whether the Bank made any provision for this in its Accounts. The Governor said that there was no provision because the claim was being robustly defended; he added that the matter had already dragged on for ten years and that it could be another ten before it was concluded; also, apart from the claim itself, there could also be the question of costs.

The Bank in the Community
(Messrs Bean, Clark, Plenderleith and Danton, together with [redacted] in attendance)

Mr Clementi thanked [redacted] from Secretary's Department and [redacted], who chaired the Community Affairs Staff Committee, for their efforts and contribution to the success of the Bank's community programme. The latter committee both had a monitoring and oversight role and also sought to engage with the Community Relations Unit in promoting the community involvement programme and staff participation. As was clear from the report, and the brochure which had been circulated to Court Members, the programme had considerable breadth and involved a lot of staff. Moreover, the Heart of the City initiative had created a substantial additional workload over the year. Mr Clementi noted that the bottom line was a request for an additional £48,000 in the community relations budget for 2002/03, which he supported.

In introducing her report, [redacted] said that it was in two parts – the first gave an overview of activity during the previous year, the second reviewed the current community involvement policy and made recommendations for the future. Looking at the past year, [redacted] noted that the Bank had committed over £634,000 to the community programme in 2000/01, an increase of some £66,000 on the previous year. Among the highlights were:

- Expansion of education business links, including a new relationship with a primary school in Hackney alongside the long-standing relationships with two Tower Hamlets primary schools. Some 40 staff visited the primary schools each week to help pupils with reading and numeracy skills. In addition, other staff acted as mentors to secondary school pupils, business partners to head teachers, facilitators at school job finding conferences and as school governors.
- Support for a research project undertaken by the Runnymede Trust (an independent thinktank on race relations and diversity) investigating business involvement with school mentoring programmes, particularly those aimed at raising the educational standards of underachieving groups of black and ethnic minority pupils. The study had culminated in the publication of a briefing paper and a good practice guide for business. These were endorsed by the Director of Education at Business in the Community (BITC) and formally launched at the Heart of the City Carnival on 27 June. The Runnymede Trust had been extremely pleased with the outcome of the project.
- Staff fundraising activities, which had raised substantial funds for various charities – including the Samaritans and the National Asthma Campaign, the staff charities of the year for 2000. All funds raised were matched by the Bank from the Community Relations budget. Separately, staff raised over £9,000 for the daughter of a staff member who, after contracting meningitis last summer, underwent multiple amputations and who would now be starting at university this autumn; the money raised had largely been used to fund a bespoke artificial leg. This was a splendid example of staff solidarity and team effort for a special cause.
- Bank support for staff through the newly introduced Civic Duties and Volunteering Leave Scheme (35 staff took a total of 144 days) and the continuing and successful Staff

Volunteering Award Scheme (171 staff received donations for charities, schools and community groups in which they were involved).

[redacted] drew attention to new projects which were being developed. These included a pilot scheme with BITC and Fullemploy to match staff as partners with black and ethnic minority voluntary sector businesses (for this, Community Relations were liaising with Personnel to find suitable staff who would benefit from the development opportunities which the scheme would offer); and an e-mentoring programme with secondary schools in Greenwich, an initiative which had great potential in London boroughs which were difficult for City people to visit.

Turning to the triennial review of the Bank's community involvement policy, [redacted] recalled that the main elements were:

- To support and encourage staff in their work for the community.
- To support local and national projects which enabled people from disadvantaged backgrounds to access training or education leading to worthwhile employment.

The policy had been introduced in 1995 and had not changed greatly since then, nor had the environment for charitable activities generally. The proposed new policy, circulated to Members of Court, did not contain any major changes of direction but the language had been updated to reflect the shift in emphasis to a more staff-orientated scheme. The new policy also included the evaluation of programmes which the Bank was involved with in order to ensure that they were making a difference to the community.

[redacted] said that she was looking for Court's endorsement for the new community involvement policy statement and also for a £48,000 increase in the Community Relations budget for 2002/03. The latter was to allow an increase from £3,000 to £5,000 in the allocations to each of the Agencies, Registrar's and Printing Works for local donations to charitable and community causes (the allocation was essentially unchanged since 1993) and for a planned Court Awards Scheme to give further recognition to the staff's community efforts.

Concluding her report, [redacted] noted that, to raise awareness of the community involvement programme, copies of the brochure – which Members of Court had received – had been sent to all members of staff. The past year had been an extremely busy one, not least because of the extra work which the successful Heart of the City initiative had involved. Interestingly, a contact in the voluntary sector had had quoted to her, by third party, the result of the survey on City community activity which the Bank had undertaken for Heart of the City.

Mr Morris noted that the report revealed a high level of activity but was unclear about how much took place in the regions. He was concerned that the Bank was a national organisation but the focus of the programme appeared to be on the London metropolitan area. [redacted] said that the Agents' budgets were used for donations in their respective areas but, centrally, the Bank supported various initiatives with a national focus.

Ms Blow noted that there was an evaluation of the impact of support to charitable organisations, and asked whether there was also measurement in terms of the impact on staff morale and of the Bank's external image. [redacted] replied that there was good anecdotal evidence that the community programme had a positive effect on morale; and the Governor confirmed that his soundings among staff he met from around the Bank was that people were enthused by the programme.

Mr Hall noted that he had been involved in similar activities for twenty years and commended the programme. Dr Julius similarly supported and applauded the programme, and noted that, from her own knowledge, [redacted] achieved a lot with her small team; she asked what proportion of staff were actually involved and whether it was feasible to set a target to raise the numbers. The Governor asked that subsequent years' reports should indicate the numbers, but he thought that it would be difficult to set targets in this area.

Mrs Francis said that she was impressed with the programme, and endorsed the proposed budget increase. Picking up on the question of measuring the impact on the Bank's external image, she asked if Court considered the Bank's overall objectives in terms of public image, and how the community programme fitted into this picture. The Governor agreed that this might be the subject of a future paper to Court.

Mr Stretton also noted that the programme was excellent, but asked if more could be done to emphasise the real development opportunities for staff, eg in such skills as risk analysis, project analysis. Ms Blow confirmed that, for many companies, staff development was the main driver in their community programmes.

[redacted] explained that the Bank was certainly moving in that direction. She was in regular liaison with Personnel Division on using the development opportunities which the programme offered; and she noted that this would be a particular feature of the BITC/Fullemploy pilot scheme to match staff as partners with black and ethnic minority business sector business which she had mentioned in her report. Mr Clementi instanced the staff acting as school governors as another example of where this was happening.

Sir David Cooksey said that – together with Sir Howard Davies – he had recently attended the launch of Enterprise for All, which was all about getting people involved in exactly the way which the Bank was doing. It was right that the Bank should be a beacon in community involvement, and the programme was a real opportunity to enhance the Bank's reputation in the wider community and to achieve positive publicity.

Mr Bailie said that he was impressed with the programme – and with the brochure. He added that, while hard to measure the benefit, the facility for Non-Executive Directors to host a charitable function in the Bank was both very valuable and much appreciated.

Court ENDORSED the new policy statement which would form the basis of the Bank's community involvement for the next three years, and the proposed budget increase for 2002/03.

The Governor thanked [redacted] for her report and for the efforts which the Community Relations Unit put into delivering the Bank's community programme.

The Centre for Central Banking Studies Report
(Messrs Bean, Clark and Plenderleith together with Professor Sinclair and Ms Hammond in attendance)

In introducing the Report from the Centre of Central Banking Studies, Professor Sinclair noted that, since the last report two years ago, he had arrived as Director of CCBS, Gill Hammond had replaced Jo Place as Deputy Director and the Centre had relocated to Head Office. The purpose and functions of CCBS remained unchanged – furthering the Bank's core objectives by promoting global financial and monetary stability through training staff from overseas central banks: the provision comprised courses and workshops in London and abroad, technical assistance, study visits and collaborative research projects. The CCBS had a wide geographical reach (124 countries in the last financial year) and emphasised learning from diversity. There was an excess demand for services, and requests for courses both in London and abroad had to be turned down. The Governor added that the Centre was a major contributor to the Bank's international public image.

In response to Mr Hall, who noted that the report did not mention financial performance and asked if CCBS made a profit, Professor Sinclair said that, as was traditional for central bank technical assistance, no change was made: there was some subsidy from DFID (up to £200,000 though not always fully drawn). Total net expenditure was £1.2mn. Unlike the French and Germans, the Bank did not fund travel and accommodation costs.

Sir David Cooksey asked how the Bank's provision compared with that of other central banks. Professor Sinclair replied that it was broadly similar to the Banque de France, the Bundesbank and other West European central banks but the CCBS programme was bigger and covered a wider range of issues. Participants' comments suggested that, on the whole, CCBS courses were better regarded. The impression was that the Bank was generally ahead of the game but there was no complacency and opportunities were taken to visit the courses which other central banks provided and to take a view on what they were doing. The Federal Reserve offered little training. The IMF provided a lot, but was seen as less good than the central banks and was perceived in the developing countries as too didactic. In contrast, the CCBS approach was not about selling a package but having a conversation and sharing views and experience.

Dr Julius said that she was a strong supporter of CCBS. Looking ahead, she asked if the Bank was offering the right courses, and, how the provision might look in 3-5 years' time.

Professor Sinclair believed that demand would continue to rise. He foresaw more international contact and more complex financial stability issues to be addressed. The current portfolio of activities was carefully balanced between core work with poor countries with unsophisticated financial systems needing help at the basic level and those with more developed financial systems. He believed that there would be more demand in the latter category over the medium term.

Ms Hammond added that the provision was demand-led in response to identified needs. But CCBS was always looking to improve the efficiency of delivery. Enhancements in hand included on-line course administration via the internet, using video conferencing and putting presentations out via the internet.

The Governor recorded his appreciation for the efforts of the CCBS team, which undoubtedly enhanced the Bank's reputation around the world.

Matters Reserved to Court
(Messrs Bean, Clark and Plenderleith in attendance)

Under the annual review by Court of "Matters of Reserved to Court", Mr Clementi proposed two small revisions to bring the document up-to-date and aid clarity. The first reflected the fact that the appointment of Members of Court and of the Chairman of NedCo was the responsibility of the Chancellor. The second involved designating the internal Committees of Court, such as Audit Committee and Remuneration Committee, as Standing Committees in order to differentiate them from NedCo.

Court ENDORSED the proposed amendments to " Matters Reserved to Court".

Court was up.

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 15 AUGUST 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir John Bond
Mrs Francis
Mr Hall
Dr Julius
Mr Neill
Sir Neville Simms
Mr Stretton

Absent:

Mr Clementi, Deputy Governor - Financial Stability
Sir Howard Davies
Sir Ian Gibson
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Ms O'Donovan

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

MONETARY STABILITY ISSUES

The Inflation Report, together with the economic and monetary discussion, incorporating the monthly MPC report to Court
(Messrs Bean and Plenderleith in attendance)

In introducing the Inflation Report and opening the economic discussion, Mr Bean said that the international situation continued to be a major part of the MPC's considerations. In the US, GDP had increased by only 0.2% in Q2 and retail sales had been flat in July. Consensus forecasts for economic growth this year had remained in the 1.5-2% range over the past few months. The MPC's own US forecast was close to the consensus, and envisaged a moderate pick-up next year, reflecting both planned tax cuts and monetary easing this year. But the forecast had significant downside risks, first from a more prolonged pause in investment and, second, from the prospect of lower consumer spending in the event of unemployment rising more sharply. It was, however, the euro area that had provided the main news over the past few months with weaker domestic demand accompanying the external downturn. Confidence also seemed to be declining. Overall, these factors had resulted in a downward revision to the MPC's forecast for world GDP of around 0.5 percentage points for 2001.

Turning to the UK domestic picture, Mr Bean said the 'tale of two economies' continued, with robust household spending contrasting with a weakening corporate sector, notably that exposed to international markets. Retail sales remained strong and house prices and consumer borrowing were both increasing at an annual rate of around 10%. Government consumption was also increasing. In contrast, investment demand was weaker than anticipated. The MPC's forecast discussions had paid considerable attention to the investment outlook. This was now considered to be weaker than had appeared most likely in May, not surprising given the evident pressures on the tradeables sector.

On the output side, Mr Bean said that alongside the deterioration in manufacturing, service sector activity was also slowing. A part of this was expected due to specific factors such as foot and mouth disease. But some underlying slowdown appeared to be evident. Surveys had become more pessimistic in both sectors. Mr Bean said the sectoral imbalances across the economy were discussed at length in the August *Inflation Report*, in terms of both the financial position of households and corporates – consumers were in a better financial position than corporates – and the policy implications of the sectoral imbalances. Looking forward, an important factor would be the extent to which firms decide to retrench by cutting investment and employment. Mr Bean said the financial strains were not common across all companies; around 20% of companies were highly exposed, though neither was this a narrow sectoral telecoms story.

On the labour market front, Mr Bean said employment growth was slowing and unemployment was probably close to a turning point, although the 'claimant count' fell by 13,000 in July. Headline earnings growth was erratic month to month (4.8% on an annual basis in the three months to June), but the underlying picture – looking at settlements and earnings data –

appeared to be drifting upwards. But earnings growth was not rising in an alarming way given the relative tightness of the labour market. Inflation was also somewhat volatile month to month due to the influence of seasonal food and utility prices, and excise duties. The underlying trend was likely to be fairly flat over the forecast horizon, with some slight upward pressure building. Input price inflation was falling.

Overall, the MPC forecast was for economic growth to stay below trend over the coming two years, recovering due to higher public spending and some global recovery next year. Offsetting these factors, consumer spending was expected to slow as the savings rate increases. The risks were very much on the downside, principally from a sharper than expected world slowdown or a larger fall in consumer spending growth. These risks were, of course, related: households might decide to save more if unemployment increased significantly as companies retrenched. Inflation was forecast to dip towards 2% before rising towards the target rate. Underlying inflation was expected to be a little less than the target throughout the forecast period. Mr Bean said that it was in this light that the MPC had reduced the official interest rate in August, with a majority of 6:3 voting for a cut of 25 basis points.

Commenting on the financial markets, Mr Plenderleith added that the main development over the most recent period was a depreciation of sterling, by about 3% over the past month or so. This was mainly against the euro, which had also gained against other currencies, notably the dollar. Three factors were relevant to the euro's generalised recovery: first, a more pessimistic view of US prospects; second, a similar view of UK growth prospects; and, third, nervousness that the euro had been oversold, leaving market participants short of euro. Mr Plenderleith said these developments were taking place in the rather thin summer markets, and the movements to date were not outside the range the sterling ERI had been within over the past year. And the euro was still only around 90 US cents, well below the rate of close to $1.20 at which it had begun its life. Nonetheless, the movements, if sustained, would be helpful for the imbalances in the economy, though a sharp depreciation could have inflationary implications. For now, the question was whether these recent movements amounted to a genuine change in trend.

Interest rate expectations had fallen by 30-40 basis points since the MPC rate cut, reflecting the degree of surprise in the decision itself followed by the downbeat interpretation of the *Inflation Report*. US and euro markets were also softer and anticipating further interest rate reductions from the Federal Reserve and the ECB. Mr Plenderleith added that these expectations and the more pessimistic outlook in markets were not evident in equity markets, which had not shown any marked recent decline, though again he stressed that trading in August should not be seen as definitive.

Dr Julius asked if, as the MPC minutes discussed the problems of surprising the markets, it was felt that the markets had over-reacted to the decision? Mr Plenderleith said market expectations had changed by more than 25 basis points, which indicated a belief that the outlook was softer and that more interest rate reductions could follow. Expected rates had risen slightly since – by around 10 basis points the previous day. It was not easy to judge if the market had over-reacted. The main point was that the market now had an expectation of further cuts rather than no change, or even higher rates.

Ms Blow said she viewed the IT services sector in two distinct parts – that serving a buoyant public sector, and that serving an uncertain business sector. Within the industry, there was an expectation of strong future growth in IT outsourcing business and a more sanguine view of investment in new IT systems.

Mr Neill said the car market still appeared strong. Sales were around 11% higher in July compared with a year earlier; and 5% in August on the same basis – the retail market was stronger still. Indications for September, based on orders intake, suggested very strong growth. This might reflect the introduction of a new registration plate design that would exaggerate the underlying strength of demand looking ahead. The year-on-year comparisons might also be complicated by a shift back to UK-sourced sales rather than imports via the internet which had not been previously captured by the figures. Nonetheless, there had been a change in sentiment by consumers – they no longer expected prices to fall – and there were many new models in the market. Overall, sales in 2001 were likely to be the highest on record.

Sir Neville Simms said construction output continued to grow. The order intake had slowed, as the Bank's Agents had reported. He added that, in terms of future demand, a good deal rested with the public sector. He said prices were still rising – both for materials and labour – and were probably not at their peak. But prices would probably respond quickly to any clear downturn in orders.

Mr Hall noted that the global slowdown was having an impact on inward investment inquiries, although this was less evident in Yorkshire & the Humber and Eastern regions. Mr Bailie commented on the situation in Northern Ireland. He said the political picture was dominating the mood at present. Aside from this, he said the return on investment in the printing and packaging sector had fallen sharply – from around 15% to around 8%. He said this could result from a wave of investment that had not yet reached a payback stage. But this was not evidently the reason. Given that it was a fairly significant fall in profitability, it was a concern. He said he thought it was driven by import substitution, as companies become more sure that exchange rates were likely to stay around current levels, particularly the Euro. He also noted that advertising revenues were now falling though there was some expectation of a pick-up; and that tourism had been better in June than April/May.

Mr Stretton asked how lower interest rates were likely to impact on the corporate side of the economy, given that the effect might not be favourable in terms of the consumer side of the economic imbalances. Mr Bean said there were essentially three routes within the transmission mechanism: consumption, investment and the exchange rate. He said the consumer was clearly alive and well and did not need lower interest rates. Investment was likely to remain depressed though lower interest rates would reduce interest payments. The key was probably the exchange rate channel. A lower exchange rate and higher interest rates would be preferable in terms of addressing the imbalances in the economy. But the link between interest rates and exchange rates had been perverse over recent years – with currencies appreciating with rate cuts because interest rate reductions were seen as improving the outlook. The latest MPC minutes discussed this, noting that the exchange rate could rise. So far, this had not happened.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues
(Messrs Bean and Plenderleith in attendance)

Mr Plenderleith updated Court on discussions with HM Treasury about the future of gilts registration. The Bank operated on the basis of a five-year contract to act as the Government's registrars, which currently included an operational requirement to keep the cost of registration below £4.30 per account. To achieve this, costs had been reduced. But within an environment of a continuing reduction in the numbers of accounts on the register, it was apparent that the present cost base was not sustainable going forward. A number of options were put to HM Treasury last year, following a discussion with Court in April 2000. These related to the period beyond 2003 when the present contract would run out.

Mr Plenderleith said the possible options for the business fell under three headings: first, expand the business by increasing throughput, eg by merging with the separate Irish register and possibly integrating all Government registration requirements (e.g. livestock) under one agency; second, re-engineer the gilts registration business, linking registration to the electronic settlement systems and possibly outsourcing some functions; and third, merger with an outside commercial registrar, possibly through inviting tenders. Mr Plenderleith said the response to date from HM Treasury was that they did not favour the first two options and did not have much appetite for putting the business out to tender. The likely preferred option was therefore to leave the business with the Bank and look to us to re-engineer aspects of the operation. HM Treasury had mooted the idea of a two-year extension to our existing contract but that was not acceptable to the Bank, Mr Plenderleith said. If we were to continue the function, we would look for a longer planning horizon, perhaps 8-10 years. The Bank would consider further the strategic options and report back to Court when HM Treasury had received responses from ministers.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Messrs Bean, Plenderleith and Tucker in attendance)

In updating Court on financial stability matters, in the absence of Mr Clark, Mr Tucker said that he wanted to highlight three current items of interest. First, he said it was now some 18 months since the Cruickshank review of banking had made recommendations concerning competition in payment systems. The recommendations had been accepted by HM Treasury in March last year and on 3 August this year the Government had published its proposals for consultation. The Office of Fair Trading (OFT) would oversee competition in payment systems. Importantly, the proposed statute would recognise the Bank's oversight role in relation to systemic risks in payment systems, and would provide for exchanges of information

4

between the OFT and the Bank. The OFT would be obliged to consult the Bank regarding the development of rules where these were relevant to financial stability and systemic risks. The main uncertainty was one of timing i.e. when the arrangements would become law and operational.

Second, Mr Tucker reported on progress with the Continuous Link Settlement project to reduce settlement risk in the foreign exchange market. This was a private sector initiative involving major institutions and IBM. The Bank's interest related to the efficiency of the market and the risks within settlement systems. The project had been delayed in the past and presently had been deferred because of technical IT problems. This was not, at present, thought to be a deep problem but resolution would take some time.

Third, Mr Tucker referred to the present conjuncture in Argentina. Over the past month or so there had been large withdrawals from the banking system, some of which had been taken out of the country – often to other Latin American countries – but some held as cash within Argentina. More recently, the outflows had eased back. There was considerable market speculation about the sustainability of the country's debt position over the medium term and the role of the official sector was under considerable scrutiny. The situation was seen, in part, as a test case both for the Private Sector Involvement agenda and the new US administration. The Bank's and the UK's general position had been outlined by Mr King in his speech in New Delhi, India on 9 August. The question of the extent of contagion remained uppermost, following either a default or a rescheduling of Argentina's debt. Mr Tucker said that so far the signs were reasonably positive – there was likely to be some contagion but not on the scale seen following the financial crises in 1998 – but there could be little certainty about the likely outcome.

Ms Blow asked if the IT equipment being used in the Continuous Link Settlement project had been tested elsewhere prior to the current project. Mr Tucker said he understood the problems concerned the platform the systems would operate on but he was not close to the detail. Mr Plenderleith said this was not a Bank of England project. The Bank's interest centred on reducing real-time settlement risk within the foreign exchange market. Mr Tucker said the official sector would have to authorise the new system and that the lead regulator was the New York Federal Reserve. Sir John Bond said testing would be critical as the system was on a new platform. The Governor noted that the earlier problems were ones of project management rather than IT.

Sir John Bond said the international financial community was not looking good in relation to dealing with the Argentinian situation. He said it would be very difficult to corral diffuse creditors across international capital markets, particularly when standards of market behaviour were, at best, variable. He said Mr King's speech in India had been excellent. He felt a devaluation of the Argentinian currency would be the worst of all options. He said foreign creditors should take the strain and the official sector should seek ways to buy time. Mr King said there was currently a lot of discussion on the matter but the approach seemed to be rather one of hoping that something favourable turned up.

EXECUTIVE REPORT
(Messrs Bean and Plenderleith in attendance)

Outside Review of Bank Forecasting

Under the Executive Report, the Governor returned to the discussion on the review of MPC forecasting procedures that had commenced at Court the previous month. In addition to the paper from Mr King, Dr Julius had written a note in response. The Governor asked Dr Julius if she wanted to expand on her note. She said the review would be an important project for a key part of the Bank's work. Her note offered some suggested points of clarification about the terms of reference; in particular she felt the review should be used as an opportunity to carry out an evaluation of forecast performance – both in terms of actual economic outcomes and in comparison with other forecasts – as well as forecast procedures. Regarding the choice of reviewer, Dr Julius said she felt it was less necessary for the chosen person to have experience of a central bank and, on the basis of soundings she had taken, she believed Mr Wallis was the better choice, as outlined in her note. Dr Julius also said the reviewer might need some resources from the Bank to undertake the review, and she asked whether the review should be undertaken for the Non-Executive Directors rather than Court as a whole.

Mr King said he was not clear about the first point in Dr Julius's note. The review would consider the quality of the technical work provided by Bank staff, in terms of the work undertaken and the methods used. This would need to be judged against what the reviewer considered to be 'state of the art' procedures and methods. Regarding an evaluation of forecast outcomes, he said there was an important point of principle to emphasise: the role of Court was to monitor MPC procedures, not ex-post MPC judgements, in terms of interest rate decisions and forecasts. Mr King said there was a clear distinction to be made between an assessment of the work provided to the MPC by Bank staff and the resources employed to service the MPC, and the forecast itself, which was a result of MPC judgements. An annual ex-post forecast evaluation was published in the August *Inflation Report*, and had been approved by the MPC. The problem with this, or any evaluation of forecasts against outturns, was the very small sample size available.

In the relation to the choice of reviewer, Mr King said Adrian Pagan was the MPC's first choice. He noted that Dr Wadhwani had preferred [redacted] but was content with the MPC's collective decision. Mr King explained that Adrian Pagan was preferred to [redacted], partly because the latter had made a number of public comments about the forecast process, so he was less likely to start from a neutral position. Mr King also said he felt it was an advantage to have someone with experience and understanding of the workings of a monetary policy committee. He added that, in due course, it was expected that there would be a seminar in the Bank to discuss the findings of the review with a broader group of academics and other interested parties. Mr Bean said the forecast evaluation that appeared in the August *Inflation Report* was a summary of a longer paper produced by Monetary Analysis. Separately, [redacted] had produced a similar paper which he was coming into the Bank to discuss.

Mrs Francis asked if the final sentence of Mr King's note, "The review should not prescribe a single method of forecasting, but offer a range of alternatives, with pros and cons of each approach to be discussed", was part of the terms of reference. She felt it was unclear. Mr King said the sentence was for guidance at this stage and not aimed at providing the substance of the review which would need to be discussed with the reviewer.

Dr Julius explained that the first point in her note intended to address the issue that different models were likely to suit different approaches. She agreed that the review should not cover the ground already treated by the Kohn Report. For instance, it was helpful to the MPC if they could see the consequence of changing assumptions or other details in the model. This was relevant when deciding whether a small or a large model was the most appropriate tool. She thought it was helpful to clarify that this was a relevant consideration when evaluating forecasting methods. In relation to including an evaluation of forecast outturns, Dr Julius said, while the Bank undertook such an exercise, there were many views as to how to evaluate a forecast. An external reviewer might want to do this as a first step. This would not be a comment on the MPC's policy judgements but the forecast.

The Governor said that this approach would mean the review would be considering two separate aspects – the inputs to the forecast process and the technical aspects of the model – which amounted to a larger exercise, closer to the coverage of the Kohn report. He felt this review should focus on the procedures for an ex-post evaluation of the forecast, not undertake such an evaluation itself.

Sir Neville Simms said he supported strongly the need to distinguish between MPC procedures and judgements. He asked how 'state of the art' or 'best practice' could be determined. The Governor said both leading candidates were likely to be fully conversant with what was 'state of the art'. The preference for Adrian Pagan reflected a view that he was likely to be more objective. Mr Stretton stated that it was not for Court to comment on the MPC's outputs but the processes that produced those outputs.

In the light of the discussion, the Governor proposed to leave point four in the terms of reference as it stood; and to add the phrase "judged against the purposes set out for the monetary policy regime" for point one. The Governor asked for further comments on the choice of reviewer. Mr Neill supported the MPC's decision. The Governor said the Bank would then approach Adrian Pagan. The issue of appropriate resources to undertake the review would be part of that discussion.

Sir David Cooksey said he thought the reviewer should report to Court as a whole, consistent with the approach that NedCo would, where appropriate, work through Court rather than separate from it. He saw no need for a division here. As had happened with the Kohn Report, there would hopefully be an opportunity for the reviewer to talk to the Non-Executive Directors separately. He said the role of the Non-Executives was to establish if the MPC had the right tools to undertake its responsibilities.

Mr Hall asked, as the review was in effect an audit, whether it was within the remit of the Audit Committee to consider it. Sir Neville Simms said that it was felt that, where possible, such matters should be brought to Court as a whole. The Governor said this was a matter for Non-Executive Directors to decide. The Bank would now progress the review and contact Adrian Pagan.

Bank of England Sports Ground, Roehampton and the Lawn Tennis Association (LTA)

The Governor reported to Court the current state of negotiations with the LTA regarding proposals for a National Tennis Centre at Roehampton. The proposals very much suited the Bank. The net cost of the Bank's sports ground and facilities was around £0.9 million a year. The arrangement with the LTA would result in an annual charge to them of £0.5 million. The Bank was currently involved in legal work to progress an agreement with the LTA. There was a sticking point relating to the subsequent use of the LTA facility in the event of the failure of the tennis centre. The Bank was concerned about its control over who might operate the site if the LTA needed to exit the operation and let the facility to another party. The Bank had explained that a subsequent future use would be a sensitive issue. The Bank had specified that future use should be for "other tennis purposes". The question was how reasonable that was and how far the Bank was prepared to broaden the conditions of future use of the site. Two proposals had been suggested: first, to shorten the break point in the lease from 25 years to 15 years; second, to undertake for the Bank to lease back the facility from the LTA. Neither were considered acceptable. Faced with this situation, the Bank proposed to proceed by an exchange of side letters undertaking to consider any future applications for use of the site other than for tennis purposes in a constructive and reasonable way. The Governor asked if Court was happy for the Bank to proceed in this way.

Sir David Cooksey said that it was a reasonable approach on the part of the LTA and not unusual in a commercial environment. He said he hoped Court would approve the letter. Mr Bailie asked if the Bank's lawyers were happy with the term "reasonable". The Governor said the Bank had considered allowing "other sporting activities" but that could imply a great variety of potential uses. The Bank's lawyers were happy with the proposals. Court APPROVED the proposal.

Bank of England website - recruitment

The Governor drew Court's attention to an award given to the recruitment area of the Bank's external website by the Association of Graduate Recruiters. The Association had judged the Bank's site the best of all the websites it had reviewed in the graduate recruitment market. The Governor said he was extremely pleased to report this achievement.

October Court meeting in Cardiff

The Governor said the programme for the Court meeting in Cardiff was materialising. A list of planned events would be circulated shortly and the Governor invited Members of Court to signify those in which they wished to participate.

MANAGEMENT OF THE BANK

A Report from the Chairman of the Audit Committee
(Messrs Bean and Plenderleith in attendance)

In introducing the draft minutes of the meeting of the Audit Committee held on 20 June, along with the revised terms of reference of the Committee, Sir Neville Simms said that the Committee had discussed the Bank's approach to the management of operational risks, and the Bank's procedures for credit assessments. The Committee had received excellent presentations on both topics. Mr Clementi had decided to establish a sub-committee reporting to MANCO, to consider operational risks facing the Bank. Sir Neville said this was a better option than a separate risk management committee as it maintained line management control and ensured there were no gaps in the process.

Sir Neville added that he and the rest of the Committee had been impressed with the focus and commitment of the people involved in this work within the Bank. Both the internal and external auditors had reported positively.

Mr Stretton said the Trustees of the Pension Fund also needed to think about risks but not separately from the rest of the Bank. He asked that this point be taken on board by the Audit Committee.

Turning to the terms of reference proposed for the Audit Committee, Sir Neville said they were an expansion of the existing remit in the areas of business risks and financial controls. The next step was to move towards Turnbull compliance. He said there was a small amendment suggested by Sir Brian Moffat in relation to the internal audit remit. This was to add the word "annually" in "to review (annually) the internal audit programme".

Court ENDORSED the revised terms of reference of the Audit Committee. The Governor expressed his appreciation of the work of the Committee. Sir Neville expressed his appreciation for the work of Mr Bennell, the secretary of the Audit Committee. Mr Bennell was changing his position within the Bank so would be relinquishing his role as secretary.

Sealing Committee Authorisations for Inspection
(Messrs Bean and Plenderleith in attendance)

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

Court was up.

19 September 2001

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 SEPTEMBER 2001

Present:

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

Absent:

Mr Bailie
Dr Julius
Dame Sheila McKechnie
Mr Morris

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC report to Court and international economic developments.
(Ms Barker and Messrs Clark, Bean, Plenderleith and Bailey in attendance)

Updating his paper to Court, Mr Bailey noted the huge uncertainties surrounding the economic impact of the terrible events in the US. Principal among these were: the response of households and firms in the US and overseas; the immediate direct costs – structural damage, the loss of human capital; the longer term effects from business costs rising – e.g. through greater security costs; and what happens next in terms of the political and military response.

The US economy already had substantial imbalances both internally and externally. Personal consumption had supported growth, but that was a source of risk to the outlook, and much depended on the speed and scale of support from monetary and fiscal policy. In the context of a shock of this magnitude the risk of a sharp weakening was much greater. It could trigger the downturn in consumption that macroeconomic policy had been seeking to offset until the inventory correction had worked through and the capital stock of firms (particularly ICT) was nearer to an equilibrium level. Moreover, there had been a highly synchronised downturn in the world economy so that no country or region stood out as an offsetting influence. The downturn had been concentrated in investment goods that were highly traded, particularly ICT. This meant that the propagation of the shock around the world had been faster, deeper and more widespread.

Initial, but highly uncertain, estimates of the costs of rebuilding were in the order of $20-30bn (around 0.25% of US GDP). Rebuilding costs following the 1995 Kobe earthquake were around $120bn (3% of Japanese GDP). With hindsight such direct impacts of disasters tended at the aggregate level to be less than predicted, though there were often sharp differences in sectoral effects. There had been a sharp fall in US retail sales immediately after the attacks. This was the so-called CNN effect, but with much of the ground made up by the weekend. But there could well be more persistent negative effects on consumer demand. Consumer confidence could be an important guide. Confidence was for the most part an echo of economic news, but in a disaster it would probably reflect other news, and confidence could be more volatile. In the Gulf War period there was a very sharp fall in confidence when Iraq invaded Kuwait, but a sharp recovery when Operation Desert Storm began.

Oil prices had risen immediately after the attacks but had settled around $28pb, nothing like the rise seen in the Gulf War period. This probably reflected OPEC's commitment to ensure adequate supply to keep the price in its preferred band, and its success in that objective over the last year. In conclusion, Mr Bailey said that while disasters often in retrospect did not have major discernible macroeconomic effects there were three very big caveats: the possible interaction with the pre-existing US imbalances and the weakness across the world economy; the likely longer run impact on the costs of production; and uncertainty about what would happen next and what the economic impact of that would be.

Introducing his charts, Mr Bean noted that consumption was still strong and retail sales were up in August, but investment and net exports were weak. There was a continuing widening of sectoral imbalances, and some weakening within services. He commented that there was a possibility that the labour market was at a turning point because it had stopped tightening and was flattening. He also drew Court's attention to the RPIX inflation rate of 2.2% in July, rising to 2.6% in August, though some of this increase was likely to be temporary, and noted that producer price inflation was subdued. He reminded Court that at the scheduled meeting in September the MPC had voted to keep the repo rate at 5%. Turning to the effects of the attacks on New York and Washington on the UK, Mr Bean said that there was an immediate possibility of disruption to financial markets, which had been negated by supplying adequate liquidity, including a dollar / sterling swap facility. There were both supply and demand effects on the UK economy. Export demand was lower and there were negative wealth effects from equity price falls, and weaker confidence from increased uncertainty. With respect to supply, there were adverse effects from increased security costs and other factors, and possible increases in oil and raw material prices. He believed the scale and duration of these effects were extremely uncertain and depended on political and military developments.

Turning to monetary policy, he noted that the Fed had cut rates by 50 basis points ahead of the reopening of the New York Stock Exchange, to sustain confidence, and there was a subsequent unexpected cut of the same amount by the ECB. He noted that the MPC sought to be analytic and considered in its approach, and believed it was too early to assess the full economic implications of the strike against the US, although they were clearly adverse. Against this background a cut of 25 basis points was made at a special meeting of the MPC the day before Court, allowing for fuller consideration at the MPC's October meeting.

Turning to the markets, Mr Plenderleith commented that it was early days but on the whole they had behaved relatively steadily, without huge panic, and had accommodated essential business. The infrastructure had been extraordinarily resilient in the face of a totally unexpected event.

In response to an invitation from the Governor, Ms Barker said she had nothing to add.

In response to a question from Sir Brian Moffat, the Governor said there had been almost continuous exchange of information among central banks. There were regular discussions to inform each other of what was in mind. He noted that central bank governors had met in Basle the weekend before the outrage, and it had been clear from the discussion that the Fed was likely to move at its next scheduled meeting. Subsequently, it was the practice that banks would not tell each other what they were going to do in advance of a decision, but would indicate to each other what they had decided just before they announcements were made. That was what had happened with the Fed on Monday. What the Bank of England did not know at the time was that the ECB was going to react immediately, which was a surprise. The Bank was told just before the ECB announcement. However, that was typical of the way things worked. What central banks never did was to get into teleconferences to agree to do the same thing at the same time. The Governor said he was quite surprised that the ECB had acted as quickly as it did. The MPC had to take account of what the ECB had done in its own deliberations, but the UK's situation was different. He believed the MPC had acted in a calm and considered way.

Sir John Bond commented that the markets' response when they reopened in New York was extremely measured. A lesson banks had learned was that the technology base withstood the attack extraordinarily well, and he noted that the cellnet telephone system worked well, while fixed lines worked badly, after the outrage. All organisations now needed to think further about contingency arrangements. Mrs Francis noted that the greatest impact in the UK came as a result of the market uncertainty, which was giving difficulties to some companies in the long term savings markets. Some companies were experiencing pressure on their solvency margins. Mr Neill said that in the car market the first ten days of September showed an increase of 29.5% against a forecast of an increase of 17.5% and, if it continued at that rate, the full year would produce an all time record. He also noted that imports were 80% of the market, an all time high. Given that a lot of the demand was momentum from previous months, the time to look for the impact of the previous week's events was from November onwards. Sir Neville Simms said that his view remained that the construction industry was close to the top. Sir Ian Gibson said that in the motor industry the performance on the continent was flat and edging towards down, dragged mainly by Germany. He had heard anecdotal evidence of customers walking away from options on order books for expensive premium vehicles. In the US a number of manufacturers were signalling progressive reductions. One reading was that these were cuts already in the pipeline.

In response to a question from Mr Hall, the Governor said the Bank had a role with respect to the search for terrorist funds, in that it was responsible for implementing UN financial sanctions. Mr Plenderleith noted that the Bank was the Treasury's Agent in implementing statutory sanctions on money held in specific accounts. There were sanctions against Iraq and the Taliban. A question being considered by the Government was what could be done to beef up action generally, as opposed to action on specific accounts. The Governor noted that this would be discussed at the Ecofin meeting the following week. Money laundering was separate from the application of sanctions.

Sir David Cooksey noted that the one of his companies supplied base station equipment for G3 networks and had heard from customers that they were delaying for six to twelve months the roll out of G3. This was bad news. Ms O'Donovan said that the biggest issue for FTSE companies was their concern about liquidity. The banks had been reeling from the funding demands of the telecoms industry. There were concerns now about the funding requirements of airlines if they were not helped by Governments. This had led others in the corporate sector to worry about more general issues of access to bank liquidity over the following six months. Ms Blow said that she was a little concerned that public sector budgets, which had been quite buoyant, might be switched if the situation got more difficult.

In response to another question from Ms Blow, the Governor confirmed that this was the first time the MPC had held an emergency meeting, and he was content with the process. Mr King noted that the MPC had decided to time the publication of its decision at midday, as it did for normal meetings, and that the minutes would be published at the same time as the minutes of the next meeting. In response to a question from Sir Howard Davies, Mr King said that if the MPC met formally, it was obliged to publish the minutes and the decision. It was his hope that it would be a long time before the MPC had another unscheduled meeting. In response to a question from Mr Neill, the Governor noted that before the outrages in the US the Bank had looked at a scenario of an aircraft hitting the Bank and another hitting New Change as part of its contingency planning exercises.

ONS presentation by their Executives
(Ms Barker and Messrs Clark, Bean, Plenderleith, Cook, Kidgell and Jenkinson in attendance)

The Governor welcomed Messrs Cook and Kidgell from the ONS and thanked them for agreeing to speak to Court about their organisation's provision of statistical information to the Bank, which fed into the MPC's processes.

Mr King noted that one of the most important inputs to monetary policy decisions was the range of official data. The Bank had a Service Level Agreement on data provision and Court received an annual report on that. Court had shown a great interest in the issue of statistics which was why it had been thought useful to invite Mr Cook and Mr Kidgell to the meeting.

Mr Cook and Mr Kidgell introduced their paper. Mr Neill asked Mr Cook whether he would score the ONS performance in a number of areas. Mr Cook said the ONS was pretty effective in running surveys, but where it had to do more was in improving response rates. On the latter he would score six out of ten. The ONS's data ended up in a great many repositories, and it was looking to a single repository for all the statistical data that came in. In that area he would score the ONS at two out of ten. Because of that the ONS's ability to make major changes was limited by its systems. It took time to make enquiries into old files. In that area he would rate the ONS at three out of ten.

He believed the ONS had the ability to change very substantially. That was where the Bank would see a major shift, in the ONS's ability to do new things. He noted the significance of publishing information on the web. Reuters, DowJones and Bloomberg carried large amounts of information, and one day there might even come a suggestion that the publishing of information might be handed to an agency such as Reuters. At the moment, a large part of the ONS's information was published in very expensive books. He noted that the ONS was setting up a start-up business unit. Making changes in such an innovative area was very hard if those responsible were caught up in the effort of doing day to day work, yet there were big changes to make. He also noted that the ONS operated a registry of life events. For example, half of the population change in Britain was due to migration. But the ONS was unable to measure population change at the moment. The quality of public policy in a number of areas such as population change, health education and the labour market was eroding as a result. The ONS had a good labour market survey, but its ability to map it into the population of Britain had also eroded. The UK as an island country operated without a register of population but perhaps should operate more like a land blocked country. These were areas in which the ONS had a lot to do.

He also noted that the ability to use administrative and tax data was changing rapidly, because other departments were becoming more effective in their use of data. Turning to the use of resources, he said that if there were significant tension over their allocation, his only response would be to make a proposal to the Treasury for more finance. One of the problems was that, because of traditional cash accounting, setting priorities meant deciding what to drop off. This was more important than the ability to decide what the ONS should do. The Bank had to give as much guidance as to what it did not need as to what it did need. In response to a question from Mr Hall, Mr Cook said that the Bank of England was one of the ONS's half dozen biggest customers and all for different reasons could not be ignored. It was rare to have an executive meeting without the Bank of England being referred to. Part of the ONS's job was to provide the MPC with information, but also it provided information for other people to judge whether the MPC was working. He noted the enormous difficulty of repeating the measure of GDP at a national level, which was hugely complex, at a regional level. To do this in the regions was almost impossible. For example trade flows between regions were not measured. Instead, regional GDP figures were obtained by allocation, using the income series. Mr Kidgell noted that a start had been made with neighbourhood statistics, and some speeding up had also been achieved with those regional GDP figures which were produced.

Sir David Cooksey welcomed the ONS's robust approach to change and was delighted that the Bank was always on its agenda. Achieving a close relationship was very important. He asked about the acquisition, development and retention of key people. Mr Cook said that the best source of recruits for the Bank appeared to be the ONS, which could not compete. The ONS was a very significant trainer of young people, who then left. He believed the UK civil service had an antidiluvian approach to pay, particularly performance pay. Having said that, there were ways of using the system more effectively. He also noted the importance, having recruited good people, of giving them the best technology, accommodation and management. The ONS had recently invested much more significantly in management training. It had been running a business as complex as an oil refinery as if it were a series of boutique batch breweries. There was one good building in Pimlico but the rest were poor, dating back to the sixties, with no investment in twenty years. It was important to get the intangibles right at the ONS because it would never compete on pay. There was always the excitement of working in a central bank to compete with. The ONS would like to say to its staff go to the central bank, but then come back again.

Mr Cook noted that he had regular conversations with Mr King and others, because it was important that the whole management chain at the ONS should have a sense of the Bank's interests. He also suggested there should be more exchanges of people, with a flow from the Bank to work at the ONS, as well in as the other direction. In response to a question from Ms Blow, Mr Cook said he would be delighted to welcome non executive Directors of the Bank as visitors, and the Bank should not underestimate the value to ONS staff of taking that interest. In response to a question from Mrs Francis, Mr Cook said that in the past, when the emphasis had been on improving existing performance, it was hard to be forward looking. It was easier to be very much more forward looking when the ONS was not spending a disproportionate time reacting to events. His perception was that during the last year the ONS had started to be a lot more reflective. Mr Kidgell said that a consensus about what was important was beginning to emerge. There had been formal meetings before, and formal letters, but now there were no surprises in those letters. The ONS was nevertheless still learning about how to tackle bigger issues. Mr King noted that there were formal MPC meetings once or twice a year at which the committee agreed and approved priorities, and that information went to the ONS. But there were also detailed discussions between the staff under Mr Jenkinson and the staff of the ONS. He noted the importance of Mr Cook's point about the need to be clear about what data the Bank wanted to give up. The Bank had never been serious about saying that in return for more it was willing to give something up. It would have to take this more seriously in future. Sir John Bond said that in the private sector the importance of seeing if anybody asked for the information was always stressed. Mr Hall said the way to ensure that was to pay for the information. That was a real mechanism for driving forward change.

The Governor thanked Mr Cook and Mr Kidgell on behalf of the whole of Court for their openness and frankness, for the very close co-operation at all levels and, for the interest the

ONS showed in the Bank. He noted the idea that the Bank and the ONS should exchange people. Such an exchange could only be constructive.

FINANCIAL STABILITY ISSUES

Review of the Financial Stability area, including domestic developments and international issues
(Messrs Clark, Bean and Plenderleith in attendance)

Mr Clark introduced his paper, and particularly noted the sections on US events, private sector involvement and payment system issues.

In response to a question from Sir David Cooksey, Mr Clark said that there might be questions about the Argentine IMF programme. Issues in relation to private sector involvement would arise even if the IMF's analysis and prescription were faultless. They arose fundamentally from the changes over the last couple of decades in which there had been very much more participation by borrowers and lenders from the private sector in international capital flows. The IMF, borrowers and private lenders required some better way to configure that relationship.

FINANCIAL MARKET OPERATIONS ISSUES

Quarterly report on current developments
(Messrs Clark, Bean and Plenderleith in attendance)

Mr Plenderleith introduced his report on three issues in the Financial Markets Operations area: the expansion of customer deposit facilities, the programme for issuing euro denominated securities, and progress on the Bank's major market infrastructure projects. There being no questions the Governor said Court took note of the paper.

Registrar's Department annual report
(Messrs Clark, Bean, Plenderleith, Sparkes and Ms Lowther in attendance)

Mr Sparkes introduced his paper. Mr Plenderleith said that Mr Sparkes had done a fantastic job in managing a shrinking business. It was only 18 months until the end of the contract with the

Treasury and it was natural to want to know at this point what would be done. The good news was that there had been a response to the policy paper put to Ministers. A slightly baffling aspect was that the Economic Secretary had agreed to several proposals which were not at all consistent. The sensible thing was to choose one way forward. It looked as if the Treasury officials were not in favour of a new long-term contract. A more probable outcome, which the Bank would favour, was to try to complete the process of merging CREST and the Register. Further consideration could then be given to what services could be provided beyond actual registration, for example payment of dividends. Consideration would then have to be given to whether what was proposed was practicable, and on what timescale. The Bank would come back to Court with proposals when these issues had been clarified. In response to a question from Miss O'Donovan about what was included in direct expenditure, Mr Sparkes said these were items that varied with volume, for example, postage, travel and communications. Miss O'Donovan noted that these had gone from 55% to 133% of staff costs. Mr Sparkes said a lot of this was to do with communications and computers. Sir Howard Davies said that Registrar's had done a terrific job of managing the cost base downwards. It looked from Mr Sparkes' projections as if they had reached the end of the road in terms of reduction of unit costs. He accepted that it was a Treasury decision, as the client. But Court was responsible for the management of the staff, and it was highly unsatisfactory for people to be working with no certainty about the future. If it would help in negotiations, the view of Court could be passed on that the uncertainty should be resolved sooner rather than later. Mr Plenderleith said that was extremely helpful, and he would be very glad to take it on board. The Governor agreed. Court's view might be helpful in giving impetus to the Treasury and in deciding on the options. The Governor congratulated Mr Sparkes on the way he had handled a difficult job over a number of years.

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

The Governor said he regretted to report a further deferral of the discussion of the strategy paper on the future of the Printing Works. It was important that the options were thoroughly researched, and it was still planned to have a paper ready for discussion before Christmas.

Mr Clementi reported that negotiations with the Lawn Tennis Association over Roehampton had ceased. The issue on which they had failed was the right of the LTA to sub-let the site to whomever they wished, if they moved out. The Bank felt that as a central bank it should have some say in who its neighbours should be. The Bank had invited Sir Ronald Hampel to look at a proposed compromise, which the Bank accepted but the LTA did not. Mr Clementi said he was not impressed by the way the LTA managed the negotiations, constantly changing the specification and allowing discussions to drag on for a long period. His belief was that income could still be raised at Roehampton, but break-even had been pushed further into the distance. The Bank was not quite back to square one. A number of different parties had approached us. The view had been taken that negotiations should be exclusively with the LTA but the Bank would now follow up other expressions of interest and would report back on the options for Roehampton.

[redacted]

[redacted]

MANAGEMENT OF THE BANK
Staff Pension Fund – amendments to Trust Deed and Rules
(Messrs Clark, Bean, Plenderleith and Keynes in attendance)

Mr Clementi reported that, in the light of changes introduced by the Pensions Act 1995 revisions in contracting out requirements and changes in practices, a review of the Staff Pension Fund Trust Deed and Rules had now been completed, and the paper circulated to Members listed the proposed amendments. There was nothing new in substance, but it was necessary to tidy up the Trust Deeds. In response to a question from Mr Hall on the basic data about the Pension Fund, the Governor offered a separate briefing for any Director who wished, and Mr Keynes noted that the Pension Fund had a £200 mn surplus at the most recent valuation.

Court was CONTENT with the changes summarised in the attached addendum. The Deed setting out the changes to the Trust Deep was therefore approved and the Resolution setting out the revised Rules was passed.

Sealings – legal advice
(Messrs Clark, Bean, Plenderleith and Glover in attendance)

The Governor reminded Members that following on from the introduction of the 1998 Bank of England Act, Court had delegated responsibility for custody of the Bank's seal to the Secretary, and authority for the seal's application to a sub-committee comprising one or more Members of Court and the Secretary. Court had also noted that, for the benefit of the sub-committee, all documents submitted for sealing were accompanied by a vetting letter from the Bank's principal, external legal advisers – Freshfields Bruckhaus Deringer.

Mr Glover introduced his paper pointing out that the requirement for a vetting letter from Freshfields related back to an era when Freshfields had a monopoly of the Bank's legal work. Not only did the Bank now have its own Legal Unit but also it used law firms other than Freshfields. In those circumstances, Mr Glover proposed that the written advice to the sub-committee in respect of documents submitted for sealing should be provided by a law firm approved by the Bank's Legal Unit or by the Legal Unit itself. The Governor said the proposals were eminently sensible. Court was CONTENT.

There being no other business, Court was up.

David Cooke

Peter Rodgers
17 October 2001

A COURT OF DIRECTORS AT THE BANK'S AGENCY IN CARDIFF

WEDNESDAY 17 OCTOBER 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Mrs Francis
Mr Hall
Dr Julius
Sir Brian Moffat
Mr Morris
Mr Neill
Mr Stretton

Absent:

Sir John Bond
Sir Howard Davies
Sir Ian Gibson
Dame Sheila McKechnie
Ms O'Donovan
Sir Neville Simms

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, incorporating the monthly MPC report to Court (Messrs Plenderleith, Clark, Bean, Allsopp, Ms Barker, Professor Nickell and Dr Wadhwani in attendance)

The Governor reminded Members of Court that the Minutes of the additional meeting of the MPC held late in September together with the minutes of the meeting held in October had been published that morning. The Governor was pleased to welcome all external members of the MPC and was very grateful to them for coming down to Cardiff.

In introducing the monthly MPC report to Court, Mr Bean noted that world growth was continuing to slow, and there was a sharp downturn in world trade. Even before the terrorist attack in the US, consumer confidence was weakening. It fell further following the attack, though it had since recovered a little. He noted the movements in US manufacturing output data, the NAPM survey, equity prices, and developments in US retail sales, together with consumer confidence trends and mortgage market developments since the attack. In the UK, Mr Bean noted the news on GDP, consumption, manufacturing, employment and inflation, together with the weekly BRC and CBI surveys and chain store reports that suggested consumption had held up well after the attacks. After September 11, equity prices had returned to pre-attack levels, but consumer and business confidence were lower. He also noted the MPC decision at its scheduled monthly meeting to cut rates by 25bp, and drew Court's attention to the votes set out in the minutes of the special and scheduled meetings.

Turning to the market charts, Mr Plenderleith said that it was not at all clear that there had been a major impact in the markets from the events of 11 September, other than the expectation that there would be short term interest rate cuts, which there had been. It was, however, going too far to assert that the heightened concern was restricted to political and military issues rather than the financial markets, where there was a great deal of nervousness.

Dr Wadhwani said it would be useful if Court could receive feedback on any reaction by firms so far in response to the terror attack. Mr Bailie, citing a number of examples, said September 11 had been used as an excuse by companies to do things they probably would have done anyway. Mr Morris agreed, citing further examples and said the Bank could help by repeating the message that it was not necessarily the case that a cut in rates would help, by reducing the value of sterling. People might then understand that something more fundamental had to be addressed, in the context of productivity and investment. He also noted the fall in air travel, particularly trans-Atlantic and Asia-Pacific, and said politicians should restore some confidence to the travelling public. Mr Neill said October had been a surprisingly good month for car sales so far, but he also reported the views of a number of car distributors, who were very nervous about the prospects for the first quarter of 2002. Problems in the supply chain were acute, and car manufacturers' confidence was very low.

Mr Stretton noted investment in long term savings had bounced back to the level at the beginning of September, and the drop had been influenced by the behaviour of the stock market. Mr Hall noted the Hawkins Report on tourism in Cumbria which would recommend further short term help. Ms Blow said no change of pattern had been noted in her sector, while Mrs Francis said there was less confidence in the insurance sector about whether future business levels would hold up, and there were upward price pressures in general insurance which derived from reinsurance. There was also concern that the insurance sector could be affected by tax increases. Sir David Cooksey said that among technology companies, cash was becoming very much more important to purchasers of equipment.

The Governor said he took the tone of the comment from Court to be that Members found the situation, so far, to be not as bad as had been expected, but that they were worried that it could get worse. In response to a question from Mr Allsopp, Mr Plenderleith said that there was a general sense in the markets that the slowdown would be more prolonged. Mr Neill said he had rarely seen such a consistent message from pension funds, which was that Q2 2002 would be much better, though they might all be wrong together.

Agent's issue of the month
(Messrs Plenderleith, Clark, Bean, Allsopp, Ms Barker, Professor Nickell, Dr Wadhwani, Mr Jenkinson and Ms Camper in attendance)

Ms Camper presented the findings of a survey carried out in July on the prospects for UK exports. Updating the survey, on the basis of conversations with colleagues, Miss Camper said aeronautics had slowed, automobile volumes were not too bad domestically, but there were real questions about exports to the US, while foot and mouth was still a problem for the food industry and in tourism. The prospects for exports to Europe and the US had been clouded by the terrorist attacks and were weaker than in July when the survey was made. In response to a question from Dr Julius, Ms Camper said that firms had given the exchange rate as a reason for revising down their export projections since January, but this was a result of the build up of pressures over a much longer period. There was only so much pain a company could take. Mr Neill agreed. Sir Brian Moffat said that, on the supply chain side, prices were being pushed remorselessly down; and after hanging on for two to three years firms were likely to pull back.

Non-Policy meetings of the MPC
(Messrs Plenderleith, Clark, Bean, Allsopp, Ms Barker, Professor Nickell and Dr Wadhwani in attendance)

Mr King noted that the paper before Court listed nine meetings held since April.

FINANCIAL STABILITY ISSUES

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

Mr Clark noted that many of the most important current questions from a financial stability point of view related to the consequences of the terrorist attacks, including financial fragility in the US, sectoral questions, particularly in insurance, and the instability of equity markets. These would be reported on in more detail in the next FSR.

There were three other issues to mention. Previous concerns about Argentina and Turkey remained, and if anything, the situation in both had deteriorated; the BIS had co-ordinated the publication of new information on the scale of foreign exchange and derivatives trading across the globe; and there had been expressions of interest in bidding for LIFFE from the London Stock Exchange, Euronext and Eurex.

FINANCIAL MARKET OPERATIONS ISSUES

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

Mr Plenderleith said that there were three issues he wished to draw to Court's attention. The first concerned the precautionary FX swap the Bank had undertaken with the Federal Reserve Bank of New York following the outrage of 11 September. The Bank swap - and he understood the ECB swap - had run off after 30 days and had not been renewed. The Bank swap had, as expected, not been used, but it had been a useful precaution.

The second issue related to the Leeds Cash Centre which had moved in recent weeks to unmanned operation overnight, with security surveillance exercised remotely from Head

Office. Finally, in relation to terrorist financing and sanctions, Mr Plenderleith explained the Bank's (limited) role as agent for the Treasury in implementing statutory UN sanctions. Nearly $100mn of suspected terrorist funds had been frozen in the UK, though all but about $250,000 had been frozen well before the attacks. The Government would be taking new powers as part of a wider attack on terrorist financing, which would be carried forward by the Home Office, the Police, NCIS and the intelligence and enforcement agencies. The Bank hoped that it could eventually step back from responsibility for the list of specific names, and the best outcome would be that it would be taken on by the police and enforcement agencies.

EXECUTIVE REPORT

(Messrs Plenderleith, Clark and Bean in attendance)

Mr Bean said that Adrian Pagan had agreed to undertake the review of forecasting in MA. A report would be made to Court in spring or early summer.

MANAGEMENT OF THE BANK

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

Mr Midgley introduced the Financial Report covering the second quarter of the Bank's financial year. There were no questions.

Mid-Year review of performance against objectives
(Messrs Plenderleith, Clark, Bean, Footman and Midgley in attendance)

Mr Footman introduced the review. In response to a question from Dr Julius about when the last staff survey was done and whether more quantitative performance measures could be identified, Mr Footman said the last survey was in 1995. A proposal for the first in a series of new surveys would, he hoped, be brought to Court. With respect to measurement, he described the Budbook process.

In response to a question from Mr Hall about whether there was a formal succession planning process, Mr Footman said there was one at Govco level for about 40 people down to HODs and potential HODs. Below that, he and Manco oversaw career development for 250 analysts and junior managers. The Governor said that NedCo may like to discuss whether Court would wish to see the outcome of senior succession planning discussions in Govco. Sir David Cooksey said NedCo would have that discussion.

Mr Neill described the technique of Policy Deployment. The Governor said the Bank could usefully compare it with its own system.

In response to a question from Mrs Francis about whether the Bank could give a presentation to Court on work the Bank was doing on euro preparations, in addition to the changeover plan, the Governor said the suggestion could be taken up when Mr Townend reported to Court.

Mr Clementi agreed with a suggestion from Sir David Cooksey that the review of performance against objectives could be used to provide Court with an update on the Bank's response to Turnbull.

There being no other business, Court was up.

21 November 2001

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 21 NOVEMBER 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Dame Sheila McKechnie
Sir Brian Moffat
Mr Morris
Mr Neill
Ms O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Sir John Bond
Mr Hall
Dr Julius

The Governor extended a warm welcome to Dame Sheila McKechnie on her return to Court and he congratulated her on becoming a Dame.

The Minutes of the Court of 17 October, having been circulated, were approved.

MONETARY STABILITY ISSUES
The Inflation Report, together with the economic and monetary discussion, incorporating the monthly MPC report to Court
(Messrs Plenderleith, Clark, Allsopp and Jenkinson in attendance)

Mr King commented that since the terrorist attacks there had been a general slowdown in the world economy. He noted decreases in interest rates by the US Federal Reserve, the Bank of

England and the ECB and said that fiscal policy was playing a part through automatic stabilisers or, in the case of the US, higher discretionary spending. In Britain, growth was higher than in any other G7 economy and unemployment was less than in any G7 economy for the first time since 1956. He introduced the Inflation Report in more detail, noting the main risks outlined in the Report. He also described the minutes of the November meeting and the vote, released just before the Court meeting.

Mr Plenderleith said that, despite recent events, the major exchange rates had been in a settled trading range, with the pound reasonably steady, between 105 and 107 on the index. The slowdown had had a more substantial effect on interest rates with market rates moving in step and largely anticipating moves by the MPC. Market rates had fallen further after the last interest rate cut but had backed up in the last week or so, partly because of the data and partly because of progress in Afghanistan. The extent to which markets expected further cuts was uncertain but short interest rates were expected to rise next year. In the equity markets, volatility was higher, but the markets were taking a reasonably optimistic view of the prospects for next year.

Mr Allsopp asked for comments on the developing contrast between the buoyant market picture and the increasing pessimism found from surveys.

Mr Bailie said his conversations suggested that this was as bad as it would get, and the evidence was that the slowdown on the ground was not as sharp as predicted. One concern in Northern Ireland was a quite dramatic slowdown in the Republic. Sir Neville Simms said that the picture was not very different in construction. If the predicted public expenditure happened, the construction industry would be strong for the next couple of years at least. Employment was still very high and there were still shortages of labour. Sir Ian Gibson said he believed the UK components sector would suffer a dramatic shrinkage in the next 12-18 months which contrasted with buoyant car sales. The problems were with the small and medium suppliers. Ms Blow said there had been profit warnings and redundancies in the IT sector, and for some categories of people pay had fallen. Discretionary spending on IT was shrinking, but outsourcing had held up. It was necessary to take a prudent view. Mrs Francis, noting that overall business had held up well for the life insurance industry - though there was gloom further out - asked whether there were concerns about household indebtedness.

Dame Sheila McKechnie, giving details of the Consumers Association survey, said the general picture was that consumers were not panicking. But it was a mixed picture and difficult to interpret. Mr Neill said that, after a strong October, the first 10 days of November were up 14% year-on-year, and November in 2000 had been very good. Car importers were making huge profits, but manufacturers in the UK were still gloomy and miserable. He agreed with Sir Ian Gibson that second and third tier component makers were likely to get a shock. Mr Morris said he saw clear evidence around him that things were going to get better and there were positive elements to work through, including the MPC's half percent cut, which was pitched right.

Sir David Cooksey said he was concerned that the increase in GDP arising from consumer expenditure was largely due to the exceptional car market and to the fact that the clothing industry was in full sales mode six weeks before Christmas, with a huge erosion of margins. Profit warnings were already coming out. He was now hearing evidence of banks closing in on small companies that were faltering, using purely formula-based decision making. Mr Stretton said there was no change in the fourth quarter in long-term savings behaviour but he was optimistic about next year provided nothing else happened. Sir Brian Moffat said that steel production fell year-on-year in October, world wide by 16% and in the US by 18%. He noted the significance of the 60% year-on-year fall in US steel imports in the light of policy moves to protect the industry. He also noted the difficulties of the aluminium industry, where substantial capacity was idle.

Ms O'Donovan said that she was pessimistic too. In the US, confidence was at an all time low. The supply chain needed credit to oil the recovery, and it was unavailable at the moment. Major firms were refusing to bond contracting companies. She also said that another review of FRS 17 would be worthwhile, noting that the Boots' decision on its pension fund was driven by corporate reporting issues, which was the wrong way round. Mr King, in response to Mrs Francis, said that income gearing was less than in previous cyclical peaks, so the financial pressure on households was very much less.

FINANCIAL STABILITY ISSUES

Domestic developments and international issues
(Messrs Plenderleith and Clark in attendance)

Mr Clark noted that in about three weeks' time the next edition of the Financial Stability Review would be published. In response to Sir David Cooksey, he said that the Bank had just completed its annual small business financing survey. Banks had shifted more to credit scoring but the Bank had not detected a squeeze of the type Sir David mentioned. However this issue might be pursued further. He noted the contingency planning work done by the Financial Stability area of the Bank, HM Treasury and the FSA, where the pace was accelerating. He also noted that the UK was about to undertake the FSAP assessment at the behest of the IMF. Finally the Bank had published a joint paper on international financial architecture issues with the Bank of Canada, which was available on the Bank's website.

FINANCIAL MARKET OPERATIONS ISSUES

Current Issues
(Messrs Plenderleith and Clark in attendance)

Mr Plenderleith noted that a six monthly review meeting with the Treasury had taken place with respect to the Bank's management of the foreign exchange reserves for the Treasury. Good performance had been demonstrated for the first half, ahead of target. The Treasury had been warned not to expect the same level of performance in the second half, not least because the amount under management had reduced quite sharply. Mr Plenderleith also noted a review of the risk control framework. The intention of the Treasury was to have its own operations compliant with the public sector version of Turnbull. A programme of work had been agreed with the Treasury.

Turning to the future of the Registrar's Department, Mr Plenderleith said the Bank had been considering with the Treasury strategic options for the registration of gilts. The discussion focussed on two options after 2003, when the five-year contract expired. The first was re-engineering, which recognised that the role of the Registrar's was not technically necessary in the modern world. This would make CREST essentially the recorder of holdings. There might then need to be work done paying dividends and redemption money, by CREST or the

Bank or by a commercial bank. The role of the Registrar of gilts would cease to exist, and this was the Bank's probable preference. The second option was for the Treasury to put the business out to tender after the expiry of the Bank's contract. The Bank would not envisage bidding for the contract because the shrinking registration business did not look sensible as a continuing operation. It had been agreed with the Treasury that the first option would be explored, but only a year would be spent on it. There were issues to do with legislation and the extent of CREST's willingness to co-operate which had to be resolved. If at the end of this time it was decided it was feasible, it would be implemented, which would take another couple of years. The Bank would remain Registrar for that period, but on the basis of full cost recovery not the target currently set. That would take the work through to the Autumn of 2004 or the Spring of 2005. If within a year it was judged that the first option was not feasible, the Bank would recommend to the Treasury that it go out to tender, which could take 12-18 months until a new firm took up the business. If necessary, the Bank would extend its operations temporarily on a full cost recovery basis. Either way the operations of the Registrar in their present form in Gloucester were likely to cease in the next 2 to 3 years. The staff in Gloucester had been informed. There was some disappointment on their part that it had not proved possible to expand the business and take on new registration business, but they recognised that that was not something for the public sector to do. The main sentiment was relief in knowing where they stood. They had jobs for the next two to three years.

EXECUTIVE REPORT
(Messrs Plenderleith and Clark in attendance)

The Governor noted that Professor Charles Goodhart had been appointed a part time Adviser to the Governors on Financial Stability beginning in January, replacing Dick Brealey, who left the previous February.

Mr Clementi said that the Bank proposed starting a series of structured staff surveys. The first would be done before Christmas, and the results would be available in the Spring, and would be shared with Court.

EUROPE
(Messrs Plenderleith, Clark and Townend in attendance)

Mr Townend reported to Court on matters to be addressed in the December issue of Practical Issues and the broader work of CUE. He noted that, by the Spring, much of the practical work to prepare for possible entry was likely to be completed and the first wave changeover would be over. The Bank would have learnt whatever lessons it could for the UK, and hopefully publish these in the next but one Practical Issues, in late May. The planning work across the City under the City Euro Group would have been taken as far as it could be, and this applied to planning within the Bank as well, and also to the Bank's contribution to the Treasury's national planning exercise.

What happened after that would depend very much on the Government and the possible timetable for UK entry, though many thought it unlikely that the assessment would take place until Spring 2003. In the light of the uncertainties, Mr Townend said that it was increasingly hard to keep his small team together. He commented that in that respect, the Bank was in no different a position to the EMU planning teams and the commercial banks and elsewhere.

In response to a question from Mrs Francis about an article by Lord Simon in the Financial Times, Mr Townend said that the Bank had been concerned to establish arrangements by which UK banks could be in a position to give euros to their customers, and in September the European Central Bank had agreed a sensible front loading strategy for "out" countries. It applied only to credit institutions and not, for example, to Travelex. He noted the Bank's contribution to training trainers in commercial banks, so that they were fully informed about the security features on euro notes, and he also noted the BBA and APACS leaflets for the wider public. He did not believe that the UK position as an "out" had affected the discussions on single market issues. Dame Sheila McKechnie noted the importance of analysing consumer issues with respect to the introduction of notes and coins, and Mr Townend agreed, but said there was a limit to what the Bank could do. Its responsibility was for the financial sector. It would be drawing lessons for that sector. The Treasury was doing a similar exercise across the whole economy, and he was sure it was aware of the importance of consumer issues. It would be looking very carefully at how the consumer received the euro, and would be drawing lessons about the kind of information campaign that the UK would have to engage on in due course.

Dame Sheila McKechnie noted that the Consumer's Association was on the Treasury Committee concerned.

MANAGEMENT OF THE BANK
Printing Works – future strategy
(Messrs Plenderleith, Clark and Thompson in attendance)

Mr Clementi outlined options A and B in the paper on Printing Works. His conclusion was that the Bank should prepare a practical proposal based on option B.

Mr Bailie said he totally supported the proposal, which was right for the Bank. The printing of notes was very much a manufacturing process, and if the Bank retained it, it would involve a large capital expenditure programme. The principle reason for supporting option B was that it was in the interests of Printing Works staff. There would come a stage where, without change, it would be difficult if not impossible, to take out fixed costs. The proposal would give Printing Works staff a bright future. The outlook would be extremely positive if the restrictions of being part of a central bank were removed.

Mr Neill said there was a strong case for option B, subject to satisfactory safeguards. It created the possibility of more innovation, and growth of opportunities for the staff. In response to a question from Mr Neill, Mr Clementi said the assets belonged to the Bank and so the proceeds would go to the Bank. Mr Morris said that at the last discussion of the Printing Works strategy one of the big concerns was a continuing decline in morale. In general the paper argued for a more detailed study of option B which was to be welcomed.

Sir Neville Simms said he welcomed an investigation to see if the Bank could get the sort of deal it required. He advised the Bank not to over specify when dealing with possible contractors if it wanted to get the maximum flexibility and input of new thoughts from the private sector. Sir Ian Gibson said he supported the proposal, and it was a good paper. Based on his experience, all the issues raised were soluble. It was important to get to the next stage as quickly as possible. It was also important that people at the Printing Works were communicated with well, and taken along the route the Bank was going. Sir Howard Davies said he supported option B, as much as anything because he did not believe the timing was going to improve. Numbers had not fallen as sharply as some had forecast, but it was known that they would not rise, and there was also significant over capacity in Europe. In 5 years time the Bank might well be in a less good position to do a reasonable deal. The alternative was likely to be a continued struggle with a subscale business. Sir David Cooksey said he supported option B and agreed with what Sir Howard had said on the timing. He noted one issue that was not in the paper, which was the cost within the Bank of placing and monitoring contracts over time, and that ought to be taken into account. Ms Blow said she agreed with the proposal. She said it was important to find people the Bank believed it could work with over the five to seven year period of the contracts. Mrs Francis said option B was the right one. She asked whether a clear statement would be made at the outset that at the end of the contract it was conceivable that the work might not continue at Debden. Mr Clementi said this was a good point. The answer to whether option B became option C would rest with Court at the time. Court could not judge now what Court would decide would be the right thing to do in five to seven years time. The Governor noted that one of the points identified had been the need for a long term relationship with the supplier. The Bank envisaged a five to seven year contract but at some point before the end of that, the Bank would be in a position of having to think about another long-term contract. The Governor proposed that the Bank should put in hand the work required under option B, and would bring the results back to Court.

Court was CONTENT.

The Bank's Strategy and Objectives 2002/03
(Messrs Plenderleith, Clark, Footman, Midgley and Jenkinson in attendance)

Mr Clementi introduced the paper, and noted that it would be cascaded down to staff in abridged form. Mr Morris said he hoped to see a very strong focus on recruitment policies, and noted the importance of having the Bank as a bridge between the City and the London Boroughs. He would like the Personnel Department to look at recruiting to ensure that the Bank was very much more representative of the UK in gender and ethnic composition. The Bank should also look to continue to maximise its own external promotion. In response to a question from Ms O'Donovan, Mr Clementi said that objective 4 was an attempt to set the Bank in its international context. The Governor said the Bank could reflect on whether this issue could be included more specifically in the objectives for the coming year. Mr Neill said he was pleased to see that the three core purposes were unchanged. Sir Neville Simms said that graduate retention was not a game the Bank could win completely, and neither should it try. The Governor commented that the Bank's concern was that it should retain the best people.

Mrs Francis said that she thought the Cardiff meeting was excellent. But she was struck, in talking to local business people, by how little they understood about external members of the MPC, let alone about Court. The objective of building public understanding could include building understanding of the extent to which there was outside input to the Bank's work. Quite sensible business people had little understanding of the structure of the Bank's decision making. The Governor agreed, in response to a question from Ms Blow, that the objectives were cascaded down the Bank so individuals understood what their parts were in the whole. Sir Ian Gibson said he was impressed with the document. As one of the most respected institutions in the nation, explaining more about itself could only help the nation. The Governor said a final version would be brought back to Court, which would take account of the comments made.

Court was CONTENT.

In the absence of the Governors and the Executive Directors, Mr Neill reported to Court on the results of the meeting that morning of the Remuneration Committee. Court was content with the new salaries proposed by the Remuneration Committee for Mr Plenderleith, Mr Bean, Mr Clark, Mr Townend, Ms Barker, Dr Wadhwani, Professor Nickell, Mr Allsopp, Mr King, Mr Clementi, Sir Peter Petrie, Mr Glover and Professor Goodhart.

Court was up.

David Cooksey

Peter Rodgers

19 December 2001

A COURT OF DIRECTORS AT THE BANK

WEDNESDAY 19 DECEMBER 2001

Present:

The Rt.Hon Sir Edward George, Governor
Mr Clementi, Deputy Governor - Financial Stability
Mr King, Deputy Governor - Monetary Policy
Sir David Cooksey, Chairman, Sub-Committee of Directors
Mr Bailie
Ms Blow
Sir Howard Davies
Mrs Francis
Sir Ian Gibson
Mr Hall
Dr Julius
Dame Sheila McKechnie
Sir Brian Moffat
Mr Neill
Ms O'Donovan
Sir Neville Simms
Mr Stretton

Absent:

Sir John Bond
Mr Morris

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

MONETARY STABILITY ISSUES

The economic and monetary discussion, including international economic developments, together with the monthly MPC Report to Court (Messrs Plenderleith, Clark, Bailey, Allsopp, Ms Barker and Professor Nickell in attendance)

In introducing his paper on international developments, Mr Bailey said that it was necessary to look through the fog of the information covering the period since 11 September. He emphasised that the evidence over recent months had revealed that the world economy was weaker than previously thought prior to September 11th. He also stressed the extent of synchronisation of the slowdown across the world's major economies. In terms of the outlook, there were particular uncertainties about the impact on confidence of September 11th, oil prices and the influence of the policy response to date, as well as the puzzling recentt strength of financial markets.

In reviewing the latest data and issues relating to the domestic economy and markets, Mr Plenderleith said the imbalances across different areas of the economy continued to be a dominant theme. However, overall, a majority on the MPC had concluded that the aggregate picture had not materially changed since the November MPC meeting. The official interest rate had been held at 4% at the December meeting. In relation to financial markets, he noted the stability of sterling. The main development had been the weakening of the yen which was in degree being countenanced to help stimulate Japanese recovery. He also drew attention to the steepening of the forward short-term interest rate curve by some 40 basis points over the past month reflecting a rise in bond market yields in all major countries. He thought the market had a bullish view of prospects ahead. Alternatively, year-end effects might have been driving the movements. Overall, he said consumer spending remained strong, government expenditure was supporting demand, investment was weakening and output growth was slowing. The labour market showed signs of weakening which might, in turn, impact on spending. Inflation remained restrained.

Mr Allsopp said Mr Bailey's assessment reinforced the questions about financial market expectations of recovery. He asked if Directors had any insights about this going forward.

Mr Bailie said the Bank's Northern Ireland Agency report suggested a relatively resilient picture in Northern Ireland. Based on his information, the situation did appear fairly upbeat. He suggested there may be a distinction between this optimism and actual activity, particularly investment. There was likely to be a boost to spending from the Republic of Ireland's participation in the launch of the euro. Cash spending ahead of the launch was spilling over into the north. He added that many retail outlets were planning to run dual pricing as they had done with the Irish punt. Information about television advertising revenues was also encouraging. Expectations had been for a decline of about 13% this year on an annual basis; December was expected to be level with the previous year. Tourist visitor numbers were expected to grow by 15-20% next year. This supported the view that the present position was likely to be the low point.

Dame Sheila McKechnie said retail sales in Scotland were some 8% higher than a year earlier in November according to RBS/Scottish Retail Consortium data, again suggesting a resilient position. Mr Hall asked at what stage the inflation target might be revisited if inflation continued to decline. The Governor said it was not really a question of revisiting the target; if inflation fell below 1.5%, he would have to write the Chancellor a letter as provided in the Bank of England Act. The November *Inflation Report* projections did not envisage a quick return to the target rate.

Dr Julius referred to the situation in the chemicals sector. She said it appeared as weak as it had ever been with no sign of reaching a low point. The extent to which the global slowdown was synchronised was the driving factor. She added that, in contrast, there were no signs of a slowdown based on lending to small and medium-sized firms, drawn from her involvement with the banking sector. Rising bad debts were not yet an issue. In response to Mr Allsopp's question, Dr Julius said the buoyancy of consumer spending and financial markets might suggest the initial links in the transmission mechanism were quite strong. It was unclear how strong the next stages would be alongside the offsetting weakness of industrial output.

The Governor said he was perplexed by the strength of consumption alongside weaker output that was not explained by higher imports. Domestic production appeared to be driven by international conditions.

Sir Ian Gibson said he was surprised by the Bank's West Midlands Agency report. Since the previous Court meeting he had consulted with a number of automotive and aerospace companies. Many were anticipating a difficult three years ahead. There was a lack of investment in product and process development as firms attempted to enhance current margins. He added that US auto sales were being driven by a need to clear stocks and to keep plants active ahead of closure negotiations early the following year.

Mr Neill said that to be confused at present was to be well informed regarding the automotive market. The recent strength of sales was also evident in the first ten days of December, and the expectation was of continued strength going forward. This raised concerns about sustainability and whether demand would suddenly 'drop of a cliff'. New models had been driving output higher but, at the same time, companies were predicting large losses. Mr Neill asked if weekend press reports about deflation were realistic.

Sir Neville Simms said the positive impact on the US economy from low energy prices was likely to continue. Prices were unlikely to firm given a number of internal industry issues including Enron. Referring to the West Midlands, he said the situation was gloomier in many sectors. But construction output this year was close to the expectations of a year ago – around 2-2.5% growth – and the forecast for next year was around 1.7%. Confidence was not weakening though the forecast depended on a 7% rise in public sector sponsored work, and some developers and housebuilders were pausing and being cautious at present.

Mr Stretton said there were a variety of views about financial markets. He observed that the more optimistic analysts tended to be the "chartists" – basing their views on comparisons with previous recessions. Sir David Cooksey said that, across a portfolio of investments in smaller companies, the industrial and commercial sector was experiencing a slowdown in new contracts, though enquiries remained evident. Cash was becoming tight, resulting in demands for working capital. He thought that once manufacturers had some confidence that the slowdown would not be deeper, orders would come on stream quickly.

Ms O' Donovan referred to the extent to which technology sectors had driven optimism. The lack of confidence at present might reflect the limited visibility of the ICT sector which does not have normal contract and order cycles. There was, therefore, little clarity about its future direction, fuelling uncertainty elsewhere.

Mr King responded to Mr Neill's question about deflation, suggesting it did not make sense to look only at the goods sector. The issue was linked to the wider imbalances in the economy. The question was how these might unwind and whether the process would be steady, as they had built up, or abrupt.

MPC PROCEDURES

Resources for the MPC including IT and Personnel in Monetary Analysis (Messrs Plenderleith, Clark, Jenkinson, Allsopp, Ms Barker and Professor Nickell in attendance)

In introducing his paper, Mr Jenkinson said that there had been little change to the structure of the support provided to the MPC. A new Division had been established to better manage the Inflation Report process and other publications. There had been a substantial expansion of resources overall in recent years, though some slippage in research projects continued to reflect staff availability. The Monetary Analysis area was now in a consolidation phase, in which the emphasis would be on retention and building experience levels, and managing new recruits within the existing structures.

Mr Bailie commented on how costs related to CRD income and asked if this was a constraint to recruiting more economists. Mr Clementi said the constraint was the availability of good economists not the allocation of CRD income to individual areas. Ms Blow said it would be useful to establish the reasons from the improvement in staff retention. Mr Jenkinson said the forthcoming staff survey would provide some information. His own view was that staff had become more familiar with what work they could expect to undertake and hence there was a better match. Changes in the pay structure might also have improved retention as might have the new 'senior economist' grade. But overall he said he did not place great weight on changes in the retention data at this stage.

Mrs Francis commented on the lower numbers of economists employed in central banks in France and Germany compared with the Bank. She said this was striking and asked if that reflected the ECB's expansion. Mr Jenkinson said he would need to check data over time. The Governor noted the wider contrast in terms of the number of economists as a proportion of total central bank staff.

Mr Hall said pay was not typically the main motivational factor across companies. Security and fulfilment were often the top priorities. He asked what was being done to enhance fulfilment of the work and whether the Bank had considered lock-in contract arrangements to improve retention. Mr Jenkinson said economists viewed the involvement in, and impact on, policy as a strong motivational tool. In terms of existing staff, responsibility for undertaking work and producing notes was being pushed down to analysts. There were good forums to discuss work and a strong training environment. Mr Jenkinson acknowledged that the monthly MPC process and the quarterly forecast and Inflation Report round did involve some repetition. He said the Bank did not employ innovative practices to retain staff through contractual conditions. The new 'senior economist' grade to enable progression without becoming a manager was an important step. Mr King said the number of economists had expanded, leading to an overall reduction in experience levels. But there had also been expansion in other areas of the Bank – an internal factor influencing retention in Monetary Analysis. Economists had sought progression through internal promotion. Over time these internal flows would benefit Monetary Analysis as well.

Dr Julius said she did not draw much comfort from the figures as the external environment had been less favourable over the past year. As the research to overhaul the Bank's model would be ready by summer 2002, she asked if the Pagan review would look at the model in this light or the existing position. Mr Jenkinson said the timing of the review was useful as it presented Adrian Pagan with an opportunity to consider the research and offer input into the modified model prior to the work being completed. He agreed the economic cycle was a relevant factor behind improved retention rates but also noted the improvement in 2000 when external conditions had been buoyant. Dr Julius asked if it was felt that staff in the External MPC Unit had good opportunities for progression and to re-enter Monetary Analysis or other areas of bank. Mr Jenkinson said that Mr Footman was aware of this issue. The new post in Personnel Division, aimed at providing career advice, was being utilised by staff in the External MPC Unit.

Sir Neville Simms said he found the paper satisfactory and asked if MPC members recognised the findings and conclusions. Professor Nickell said he did recognise the situation as described. He noted the low number of UK economists available for recruitment but said the Bank benefited from its open approach to hiring non-UK economists. The issue of moving from the External MPC Unit had not been tested to date.

Building public support for price stability

Public Relations Policy
(Messrs Plenderleith, Clark, Rodgers, Allsopp, Ms Barker and Professor Nickell in attendance)

In introducing the two papers, Mr Rodgers said that a very positive aspect of public relations in the Bank was that the outside world believed what we say. This had been built up over many years and was an extremely valuable asset. He said the importance of safeguarding this reputation was reflected in the papers. A second important characteristic was the absence of a single corporate line on policy decisions agreed and enforced from the centre. Although MPC members agreed on many aspects of policy, since 1997 the Bank had had to have a system in place to facilitate free expression of individual views. He added that in promoting the Bank and the MPC, media coverage was important, but there was a limit to what it could achieve. So the Bank had been seeking other ways to reach the general public, including the regional visits programme and the schools competition. Finally, the public relations budget numbers in the paper had been extracted from the Secretary's Department budget so that they could be seen in functional terms, but they did not yet match the categories Members saw reported to FRP .

Mrs Francis said it was right not to have an aggressive public relations policy. She said the papers focussed on processes rather than messages, and asked what were the specific themes and messages the Bank was trying to deliver in relation to Financial Stability, for example? Mr Rodgers explained that the nature of the messages depended on the external environment and changed continuously. In relation to monetary policy there were routine messages about low inflation and stability. In the early period of the MPC, effort had focussed on the need to stress that monetary policy had to be set nationally rather than regionally or sectorally. Mrs Francis said different messages suited different audiences. Mr Rodgers agreed and mentioned the extent to which the MPC regional visits programme was targeted on regional media, including drive-time radio. The messages were often very straightforward for these audiences.

Mr Hall said he was happy with the principles and direction of the work. He asked if the Bank undertook an analysis of the coverage it received in terms of the cost of equivalent advertising space. Mr Rodgers said this was not the Bank's approach but that the coverage was extensive and, in these terms, was likely to be well beyond the budgeted cost.

Dame Sheila McKechnie said she was surprised not to see a reference to a crisis management system. Mr Rodgers said public relations was a central part of the Bank's crisis communications planning. It was not covered in the paper as it was part of a broader framework within the Bank. Mr Stretton asked about media training. Mr Rodgers said all MPC members were offered media training.

Sir Ian Gibson inquired how the strategy engaged with tabloid newspaper readers, specifically those of The Sun and The Mirror. He also asked what approach would be taken in the event of continued low inflation and deflation. He added that there was a need to engage actively during subdued periods, with broad audiences away from the south-east and ivory towers to put messages across. The Bank needed to demonstrate that it understood the position of manufacturers, regional conditions etc – to head-off future difficulties. Mr Rodgers agreed and explained this was the driving factor behind the rolling programme of MPC regional visits. There was agreement across the MPC about the emphasis of these visits; the Press Office had a guidance manual for regional visits; and progress was monitored at the regular MPC Media Issues meetings. Sir Ian said these visits did not need to be restricted to senior Bank representatives. The important consideration was to be seen, particularly in more marginal parts of the economy.

Mr Hall mentioned the forthcoming Government white paper on English devolution which might be relevant to the public relations plan. Mr Allsopp said he felt the general strategy described by Sir Ian Gibson was already in place and that he had undertaken visits to remote areas of the UK. Mr Bailie said he knew of the 4-5 visits a year to Northern Ireland which he thought were excellent. He was not sure about less senior representatives undertaking visits. He said he would welcome a list of other regional visits around the UK. The Governor noted a distinction between visits and messages. He said he felt that it would be difficult for non-MPC staff to be interviewed on topical issues.

FINANCIAL STABILITY ISSUES

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

In introducing the latest edition of the Financial Stability Review, which had been published the previous week, Mr Clark highlighted the main points in his note. He said a number of risks previously identified had crystallised over recent months; that there was an increasing level of risk apparent overall, both internationally and domestically; but the state of financial intermediaries was generally strong, though this was less so for the insurance sector. He endorsed Mr Rodgers' comments on public relations and the Financial Stability Review. He said the purpose was to convey the Bank's objective analysis of issues, its familiarity with the issues and overall assessment of the risks to financial stability.

Sir Howard Davies said the latest FSR had been, in his view, the best issue to date. He said it was a great help to have the document in the market, outlining the Bank's view of risks, as background for the FSA's work with individual firms. He added that he was personally gloomier about the insurance sector and Japan. In the case of Japan, he was concerned about the lack of progress with bad loans across the banking system – the approach to write-offs appeared arbitrary. He said the next three months would be critical as the government removed its guarantees. This would impact on the financial markets' views of Japanese banks. He felt it was all over for Argentina and agreed with the conclusion about the robustness of the UK. Mr Clark said the picture in Japan was very weak though the large external asset position was still a favourable factor.

Sir David Cooksey said the FSR set out the Bank's position very clearly. He suggested some attention should be focussed on the under-funding of pensions which might hit the corporate sector after the next round of triennial reviews. Mr Clark said his area was working on the issue and available data.

FINANCIAL MARKET OPERATIONS ISSUES

Quarterly Report on current developments (Messrs Plenderleith and Clark in attendance)

Mr Plenderleith introduced his paper on the new £5 note which would include a portrait of Elizabeth Fry. The paper also described the Bank of England's three pronged anti-counterfeiting strategy. The second section of the paper reported on the Bank's C21 programme to modernise banking service systems. The third section reported on progress of the Bank's programme of gold sales. The fourth section reported on the successful completion of the third of the Bank's three major market infrastructure projects, which completed a 10 year overhaul of the UK's payment system.

In response to a question from Mr Neill, who said he was impressed that the trend of counterfeiting in the UK had been held down, Mr Plenderleith said that there was a fear that the arrival of the Euro would generate opportunities for counterfeiting of the new notes and to the extent that diverted forgeries from Sterling that would help a bit. The Bank was participating with the ECB in anti-counterfeiting measures to protect the Euro. Dr Julius commended the work reported in the paper, and particularly the C21 Project, to which the Governor agreed. Ms Blow said she had been impressed that the staff changes had been going so well.

EXECUTIVE REPORT

(Messrs Plenderleith and Clark in attendance)

The Governor said that following the success of the visit to South Wales in October the Bank had been giving some thought to the location for the next off-site meeting. The Bank was minded to visit the North West in the third week of October with events based in both Manchester and Liverpool, where there were two Agencies operating under one Agent. Further details would be available in the New Year when the Bank started to firm up the proposals.

Mr Clementi reported on discussions with the Financial Law Panel which was set up in 1993, sponsored by the Corporation and the Bank of England. Following the review at the invitation of the Governor and Lord Donaldson, it had been concluded that the Bank could not continue to support the Panel to the extent it had.

Mr Clementi said he was meeting the Panel that afternoon to discuss whether it could meet its objectives in a different and perhaps slimmed down way. The current cost of running the Panel was of the order of £1,000,000. The Governor commented that the principle on which the Bank operated was that if the financial community did not think something was worth paying for, then the Bank would not maintain it artificially. Sir Howard Davies said that the Panel had not been as effective in the recent past as it had been earlier and in developing the Financial Services Authority's legislation the Panel did not play much of a role. The approach Mr Clementi had proposed was sensible. Mrs Francis agreed and said the Panel could be helpful but not hugely so. Mr Plenderleith said he was sure that there were ways in which the Panel could be focused on a more modest and less costly basis. But there was a real role for somebody of that kind to deal with questions of legal uncertainty that could blow up suddenly. It should be scaled down but not abolished altogether.

Mr Clementi reported on the appointment of a Finance Director for the Bank. He noted that internally there had been four candidates and externally five. All were seen by a panel comprising himself, Mr King and Ms Lowther. The strongest internal and the strongest external candidates had been seen by Sir David Cooksey and by the Governor. The Bank had concluded that Clifford Smout was the strongest candidate and proposed announcing his appointment in the next day or so. Sir David Cooksey said he was satisfied that Mr Smout had all the characteristics he would look for in a Finance Director even if he did not have the formal academic qualifications. The Governor said the Bank was looking into the question of providing a professionally qualified accountant to support Mr Smout. Mr Clementi noted that neither of the two candidates on the final shortlist were qualified accountants but both were very experienced financial people.

Court was CONTENT with the appointment.

MANAGEMENT OF THE BANK

A Report from the Chairman of the Audit Committee
(Messrs Plenderleith and Clark in attendance)

Sir Neville Simms introduced the Report of the last meeting of the Audit Committee at which the main agenda items were control issues in Banking and Market Services; the new code for personal financial transactions; Turnbull reporting for 2001 including the work of a ManCo operational risk sub-committee; and the Internal Auditor's Report on the work of his Division. With respect to the Code for Personal Financial Transactions, Sir Neville said that while it was expected that Court Members should understand and comply with the principles, they would not be expected to fulfil the transaction reporting requirements.

In discussing the Report of the Audit Committee, Sir Ian Gibson said that the Committee should be asked to re-visit the safe deposit box issue at some point in the future, posing the question of whether the Central Bank should provide such facilities. Sir Neville Simms said that the issue had been left on the table. Mr Plenderleith said that the Inland Revenue was a major Government customer and the Bank provided safe custody, including the gold bullion business, so safe deposit boxes were part of the facilities on offer. If the Bank did banking at all there was a reasonable case that it maintained a safe custody business. Whether that included safe deposit boxes was something of a mute point. Sir Neville Simms noted that the Bank hadn't always known what customers deposited with it. That had to be thought through post-September 11th. The Governor agreed that the Bank could look at that, but it did know who its customers were.

The Governor asked Court whether it wanted to look into the Code for Personal Financial Transactions in more detail or whether it was content for the Bank to move ahead on this. Sir David Cooksey said that this was something that affected everybody in financial services at the moment and he believed it was inevitable, though onerous. The Governor asked Court whether it was content with the proposal in this form or whether it should come back to Court for a separate discussion.

Court was CONTENT. The Governor said that was very helpful.

There being no other business the Governor wished Court a Happy Christmas and happier year than the one just passed.

Court was up.

David Cocker

Peter Rodgers

16 January 2002