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# MINUTES OF THE SPECIAL MONETARY POLICY COMMITTEE MEETING

## 18 September 2001

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These are the Minutes of the special Monetary Policy Committee meeting held on 18 September 2001.

They are also available on the Internet:  
(<http://www.bankofengland.co.uk/mpc/mpc0110a.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee.

This meeting was convened by the Governor under the provisions of paragraph 10(2) of Schedule 3 to the Bank of England Act 1998.



## **MINUTES OF THE SPECIAL MONETARY POLICY COMMITTEE MEETING HELD ON 18 SEPTEMBER 2001**

1 The Governor convened a special meeting of the Monetary Policy Committee to review the stance of policy following the terrorist attacks in the United States, the decision by the Federal Reserve to reduce interest rates on 17 September, and the responses of other central banks to that move.

2 Following the terrorist attacks, the immediate priority for central banks and market participants was to ensure that financial markets continued to operate in an orderly manner. Central banks were providing additional liquidity on a temporary basis to ensure that there was no disruption to payment and settlement systems.

3 The more relevant consideration for the MPC related to the potential impact of the attacks on business and consumer confidence and hence on the global economy, in the light of market movements up to and including Monday 17 September and the reductions in interest rates by other central banks. In these truly extraordinary circumstances, the meeting was called under the provisions of paragraph 10(2) of Schedule 3 to the Bank of England Act 1998.

### **Developments since the 5-6 September meeting**

#### **(a) Economic data**

4 Before turning to the immediate policy decision, the Chief Economist and the Director for Financial Market Operations updated Committee members on economic data and market developments since the previous meeting.

5 Data released on the US economy since the Committee's meeting on 5-6 September had generally been weaker than expected. These data covered the period before the terrorist attacks. Non-farm payrolls had fallen substantially in August and the unemployment rate had risen to 4.9%. Industrial production had declined by 0.8% in August, although the National Association of Purchasing Managers' (NAPM) survey for manufacturing – available to the Committee at the previous meeting – had suggested a more positive outlook. However, the non-manufacturing NAPM survey for August had been weak, and the University of Michigan consumer confidence survey had fallen sharply in

September.

6 In the United Kingdom, retail sales growth had remained robust in August, with volumes up 6.3% over the previous year. Aggregate broad money and credit had also risen strongly in August (these data were available to the Committee prior to publication).

7 Labour market data were somewhat softer, however. Growth in employment on the preferred Labour Force Survey measure had slowed sharply and unemployment had risen slightly in the May to July period compared with the previous three months. The claimant count measure of unemployment had continued to decline, but at a slower rate. Headline earnings growth had eased slightly to 4.6% in July, despite a sharp rise in public sector pay growth.

8 Recent inflation indicators were mixed. Producer price inflation remained subdued. However, annual RPIX inflation had increased to 2.6% in August, the highest rate since March 1999. A temporary rise had been predicted, but the increase was above both internal and market expectations.

#### **(b) Financial market developments**

9 There had been sharp movements in financial markets since the Committee's meeting on 5-6 September. Global equity prices had already weakened after the US non-farm payrolls data were released, and fell substantially further after the tragic events of 11 September, as investors revised expectations for profitability and their assessment of risk. The Dow Jones index fell by 7% on 17 September when the New York Stock Exchange re-opened. At 9am on 18 September, the FTSE All-Share index was around 9% below the closing level on 5 September, with the DAX down by around 17%, the Dow Jones by 11% and the Wilshire by 8½%. Movements in foreign exchange markets were less pronounced. The dollar had depreciated by 3½% against the euro. Sterling had risen a little against the dollar, but had weakened by more against the euro. The sterling effective exchange rate index was nearly 2% below its level at the previous meeting. The one month Brent oil price future had risen by around \$2 per barrel.

10 Short-term money market rates had fallen markedly in expectation of further cuts in official interest rates. Rates implied by near term short sterling futures contracts had fallen by around 50 basis points between the close of business on 5 September and the close on 17 September. Moreover, rates

had dropped a further 10-15 basis points in early trading on 18 September given the widespread expectation of a special meeting of the Committee and an imminent reduction in UK rates, following the cut in US interest rates and the subsequent reductions by the ECB and some other central banks late on the previous day.

### **The immediate policy decision**

11 The Committee agreed that it was too soon to make an informed judgement about the economic impact of the terrorist attacks. The following effects were noted. In the short term, demand was likely to weaken, as financial wealth had fallen and as households would tend to raise precautionary savings while firms would respond to the heightened uncertainty by postponing or cancelling investment. However, evidence from some previous shocks, such as the Gulf War and the Kobe earthquake, suggested that much of the fall in consumption might be temporary. Further out, there was also uncertainty about the evolution of fiscal policy internationally. Global supply potential was also likely to weaken, as firms responded to the additional security requirements. There could also be a significant increase in the price of oil if tensions broadened. The outlook for aggregate profits and labour income had weakened correspondingly, which would further depress aggregate demand. Global activity would clearly be weaker than previously anticipated, at least in the near-term, but the likely balance between prospective demand and supply forces in the medium-term, and the potential impact on underlying inflationary pressure, were more uncertain. There were also likely to be pronounced distributional effects across sectors as demand patterns shifted, for example away from air transport and towards the defence and security provision industries. The impact across countries was likely to vary and might lead to changes in exchange rates. In addition, the response of the United States and the international community to the terrorist attacks was itself likely to be a source of continuing uncertainty: that response might have further profound repercussions on the economic outlook.

12 Given the uncertainties, the Committee agreed that it was essential to undertake a more comprehensive assessment of the impact of recent events for its scheduled October meeting. Some additional information on the impact on business and consumer confidence, and on financial market movements, would be available at that stage, as might information on the international political and military response. This would assist the Committee in taking a more informed judgment on the likely interplay of forces affecting demand and supply conditions and on the prospect of meeting the inflation

target in the medium term. It was recognised, however, that there was likely to be heightened economic and political uncertainty for some time. In normal circumstances, the Committee's established procedure was to review thoroughly all of the factors affecting the monetary policy decision on a regular pre-announced monthly cycle. But given the extraordinary developments of the previous week, the sharp movements in financial markets and the reductions in interest rates by other central banks, the question facing the Committee was whether there were additional risks to business and consumer confidence if this normal procedure were followed, and so whether the Committee should take action ahead of its next scheduled meeting two weeks later.

13 Against this background, various arguments were considered for no change to interest rates before the next scheduled meeting; and for an immediate reduction of 25 or 50 basis points. The Committee explored whether there was a case for making no change in rates at the special meeting, but instead issuing a public statement recognising that there had been a major change in economic conditions and announcing that the Committee would respond to that change at its next scheduled meeting. That would allow time for a more fully considered assessment based on additional information. Such a decision was consistent with the Committee's established position of adopting a measured, analytical approach, rather than responding to individual events or pieces of data. The framework of pre-announced monthly meetings was designed to support this approach and to reduce uncertainty. Making quick decisions at special meetings convened at short notice increased the risks of making policy mistakes, and of adding to uncertainty in future when there was a perceived change in economic circumstances. But the events of the previous week were truly exceptional. Although the scale of the impact of recent events on the UK economy was uncertain, the direction of that impact on activity was clear and the associated risks were plainly on the downside. Given this judgment, and recognising that financial markets and the media were now anticipating an imminent reduction in UK interest rates, delaying a policy change until the next scheduled meeting risked denting confidence unnecessarily in the interim. The Committee consequently unanimously concluded that an immediate reduction in interest rates was appropriate in the circumstances.

14 Members therefore considered the arguments for lowering interest rates immediately by 25 or 50 basis points. Most members favoured a reduction of 25 basis points. Such a cut would demonstrate that the Committee was prepared to act in response to the change in economic circumstances. Although a 25 basis point reduction would be less than the cuts made by the Federal Reserve, the ECB and some other central banks, both current economic conditions and the impact of the recent shock

differed across countries. That needed to be taken into account when judging the appropriate policy response for the UK. Before the terrorist attacks, demand conditions appeared rather more resilient in the UK than in many other countries. As a result, there was a possibility that a matching reduction of 50 basis points could convey an exaggerated impression of prospective economic weakness and affect confidence adversely. A more measured response would therefore be to reduce interest rates by 25 basis points immediately, in combination with a statement indicating that the Committee would be making a more comprehensive evaluation of the implications of recent events for UK inflation prospects at the scheduled October meeting, when more information and analysis would be available. While some of these members thought that a further reduction of rates might well be warranted in the near future, others preferred to defer that judgment until the next scheduled meeting.

15 Some members preferred an immediate reduction of 50 basis points. Even prior to the terrorist attacks, the UK economy appeared to be weaker than had been assumed in the August *Inflation Report* projections. Major global equity markets were now very significantly (between 10% to 20%) below the levels assumed in the August *Inflation Report*. The supply-side effects of the recent terrorist attacks on inflation were, in part, transient and were likely to be dwarfed by the demand-side effects. At the previous meeting, these members had either argued for an immediate rate cut or thought that one would soon be necessary. An immediate reduction of 50 basis points would be a decisive response, with a negligible chance of reversal once a fuller analysis had been undertaken. Indeed, a comprehensive assessment could well, in their view, indicate that additional cuts were needed – short-term interest rate futures contracts were currently discounting a reduction of 75 basis points before the end of the year. In consequence, a reduction of 25 basis points might be interpreted as an overly cautious response which could affect business and consumer confidence adversely and could lead to a temporary rise in sterling and/or money market rates, either of which would be unhelpful. A cut of 50 basis points would be in line with that of other central banks and was warranted now.

16 The Governor invited members to vote on the proposition that the Bank's repo rate should be reduced by 25 basis points to 4.75%. Seven members of the Committee (the Governor, Mervyn King, David Clementi, Kate Barker, Charles Bean, Stephen Nickell and Ian Plenderleith) voted in favour. Christopher Allsopp and Sushil Wadhvani voted against, preferring a reduction in the repo rate of 50 basis points.

17 The Committee agreed to publish the minutes of the special meeting together with the minutes of the next scheduled meeting at 9.30 am on Wednesday 17 October.

18 The following members of the Committee were present:

Eddie George, Governor  
Mervyn King, Deputy Governor responsible for monetary policy  
David Clementi, Deputy Governor responsible for financial stability  
Christopher Allsopp  
Kate Barker  
Charles Bean  
Stephen Nickell  
Ian Plenderleith  
Sushil Wadhvani

Gus O'Donnell was present as the Treasury representative.