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MINUTES OF MONETARY POLICY COMMITTEE MEETING 4 and 5 April 2001

These are the minutes of the Monetary Policy Committee meeting held on 4 and 5 April 2001

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0104.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting held on 9 and 10 May will be published on 23 May 2001.



MINUTES OF MONETARY POLICY COMMITTEE MEETING HELD ON 4-5 APRIL 2001

1 Before turning to its immediate policy decision, the Committee discussed money, credit and asset prices; the world economy; demand and output; the labour market; and prices and costs.

Money, credit and asset prices

2 Over the past month, equity prices had fallen sharply in the United States, the euro area and the United Kingdom, although not in Japan. The FTSE All Share index was now more than 8% below its level at the Committee's previous meeting, and nearly 12% lower than the starting point used in the February *Inflation Report*. Nor were these declines confined to the technology and telecommunications sectors, either in this country or overseas. Although the Nasdaq index had fallen by more than a quarter over the past month, broader US indices such as the S&P 500 and the Wilshire 5000 had also declined by 12%-13%. More generally, the outperformance of the high-tech sectors since 1997 had now been almost entirely reversed, both in the United States and the United Kingdom.

3 The size of these falls in equity prices could not plausibly reflect changes in risk-free real interest rates, but instead indicated lower expected profits and, perhaps, a higher equity risk premium associated with greater uncertainty about future returns. In the United States, options prices suggested that market participants now attached a higher probability than before to further sharp falls in equity prices. The declines already seen would tend to restrain the growth of private consumption (through the effects on personal sector wealth), of investment (through the effects on the cost of capital), and of exports, since this was a global phenomenon.

4 Given the volatility of equity prices, the recent falls need not imply that there had been a major change in longer-term prospects for US productivity growth. They might instead represent a correction to earlier over-optimistic expectations of earnings growth for individual companies, or indeed an overshooting on the downside. In the United States, downside risks to equity prices remained: price to earnings ratios were still above historical averages. UK profit warnings, meanwhile, remained high compared with a year ago and were widely distributed across sectors,

with an increasing number of firms citing the US slowdown as the reason for the revision downwards to their expected profits.

5 Over the period since 1995, the technology, media and telecommunications sector had accounted for all of the increase in UK manufacturing output. With the United Kingdom more dependent on this sector than many other countries, though much less so than the United States, there might be a correspondingly greater effect here from the global slowdown in these industries. The United Kingdom also had a leading position in the financial services industry, where growth might slow as a result of the downturn in financial markets.

6 In the February *Inflation Report*, the Committee had considered the risks of a more pronounced slowdown in world activity than had been incorporated in the central projection. This slowdown was assumed to originate in the United States and to be associated with lower equity prices and a weaker dollar. Such an outcome would put downwards pressure on UK inflation. But this was assumed to be offset in part by a depreciation of the sterling exchange rate index (ERI), with sterling rising by less than other currencies against the dollar. Despite the equity market correction, however, so far the dollar had remained strong and in effective terms was at its highest level since 1986. This strength was puzzling. It might suggest that market participants did not expect the slowdown in the United States to last for long, or alternatively that they had recently revised down their expectations about growth in the euro area. This, together with continuing optimism about medium-term US growth prospects (based on supply-side improvements) might explain the continuing flow into US equities from the euro area. These explanations were not fully consistent with movements in relative interest rates between the euro area and the United States. But the strength of the dollar need not be inconsistent with the falls seen in US equity markets, since the exchange rate was a relative price and equity prices had fallen sharply as well in many European countries. Dollar strength might also reflect 'safe haven' flows, although to the extent that the slowdown was centred in the United States, this was not a particularly persuasive explanation.

7 Against this background, although the sterling ERI had fallen back in recent days, it was still around 1% above the starting point used in the February *Inflation Report*. As such, it would tend to dampen upwards pressure on prices by a little more than in the February central projection.

8 Meanwhile, UK money and credit aggregates continued to grow robustly, suggesting little slackening yet in consumption growth. Household M4 had increased by 7.2% in the year to February 2001, its fastest rate for three years, while growth in M4 lending to households over the same period was just below 10%. Against a background of strengthening house prices and lower mortgage rates, growth in secured lending remained strong and the Bank's estimate of mortgage equity withdrawal in 2000 Q4 had been revised up a little. Loan approvals remained robust, if a little lower than in January, while particulars delivered had begun to increase.

9 Interest rates had also eased. If other lenders followed the reductions in Standard Variable Mortgage Rates (SVRs) announced the previous month, the effective mortgage rate would as a result eventually fall by more than the repo rate. Forward interest rates implied by short sterling futures contracts had also fallen, by between 30 and 45 basis points over the past month. The market had already priced in a reduction of 25 basis points in the repo rate for the Committee's April meeting, with market rates implying further reductions in the repo rate, to 5% or below by 2001 Q3.

10 In summary, the falls in equity prices might over time be expected to restrain demand, and the strength of sterling would exert a dampening effect on inflation. By contrast, the money and credit data and the continuing strength in house prices would tend to underpin consumption, as would the fall in interest rates faced by mortgage borrowers.

The world economy

11 In the United States, GDP growth in the first quarter seemed likely to be at or slightly above the rate assumed in the central projection in the February *Inflation Report*, and in that sense earlier fears about the downside risks had yet to materialise. But the sharp falls in US equity prices, and the continuing low levels of the major business and consumer confidence indices (which were in general only a little higher than a month ago) might signal a rather later, and perhaps more sluggish, recovery than that incorporated in the February central projection.

12 US retail sales in January had been revised up sharply, although they had fallen back a little in February. Non-farm payrolls had increased again in February, although other labour market indicators suggested that unemployment might begin to rise soon, particularly if the US economy continued to grow significantly below trend. The recent special Senior Loan Officer Survey

indicated tighter credit conditions, and also a fall in the demand for funds as a result of lower capital expenditure. This scaling back of investment plans might reflect a rise in the cost of equity capital, lower expectations of future demand (borne out by orders data), excess capacity in some sectors (with industrial sector capacity utilisation at its lowest since 1992) and lower profits, seen both in the data for 2000 Q4 and in the spate of profit warnings since then. It might suggest a more prolonged slowdown than would be implied by a purely inventory-led cycle.

13 There were downside risks stemming from the scale of the imbalances in the US economy, and in particular the size of the private sector financial deficit. A sharp cutback by the corporate sector, designed to improve its financial position, could lead to higher unemployment and a retrenchment by the household sector. Separately, the fall in equity prices could in any case prompt a rise in household savings. These effects might be offset in part by more expansionary fiscal and monetary policy. Given the continued strength of the dollar, and slower growth in many other countries, the slowdown in the United States was less likely to result in a narrowing of the current account deficit than might otherwise have been expected. A sharp correction in these imbalances therefore remained a possibility, but it was as easy to paint a scenario in which the imbalances persisted for several years, with the necessary corrections taking place more gradually.

14 The Committee agreed that the changes seen so far in business and consumer confidence and prospective corporate profitability were not obviously out of line with what might have been expected from an economy which had slowed suddenly from a growth rate of over 5% a year to little more than 1% in the fourth quarter of 2000. While this slowdown was so far no greater than expected, it was possible that the period of slower growth might be more protracted than had earlier seemed likely.

15 Within the euro area there were some signs of rather slower growth, particularly in Germany. Orders data for January had fallen sharply, and in February the IFO index had declined again, after January's rise. This weakness reflected decelerating domestic demand, in part due to slower growth in real disposable incomes. But it was important not to focus solely on Germany. Conditions elsewhere in the euro area were generally rather more robust, although business confidence was less buoyant even in France and euro-area industrial production had fallen in January; a slowdown in the telecommunications sector might also hold back growth. Nevertheless, both business and industrial confidence remained well above their long-run averages, and while forward-looking indicators

suggested some slowing to come, forecasts of growth for the euro area as a whole had so far been lowered only modestly.

16 While quarter-on-quarter movements in Japanese GDP remained erratic, there was little sign yet of any upturn in the economy; if anything, expectations of growth had fallen since February, and the Tankan survey had shown a sharp fall in business confidence. Elsewhere in Asia, growth in industrial production was slowing rapidly, in part because of the downturn in US and Japanese demand for electronic goods from the region.

17 Taken as a whole, the prospects for the world economy appeared rather weaker than at the time of the February *Inflation Report*. In March, outside forecasters had lowered their projections for growth in the United States, Japan and Germany to below the central projection in the February *Report*, and they seemed likely to revise these forecasts down further in April. That said, UK export markets, which were principally in Europe, were less affected by the global slowdown than export markets worldwide.

Demand and output in the United Kingdom

18 Quarterly real GDP growth in 2000 Q4 had been revised up from 0.3% to 0.4%, with final domestic demand now estimated to have increased by 0.9%, as against 0.7% previously. Gross fixed capital formation was now estimated to have increased by 2.6% in the quarter; within this total business investment had grown by 5.2%. These revisions resolved an earlier puzzle, as previous weak data had appeared inconsistent with the state of company finances and surveys of investment intentions.

19 Until recently, there had been little sign that the slowdown in the United States was having a significant impact on the United Kingdom. Survey data taken as a whole suggested that total export growth was unlikely to slow much in the first half of 2001. This might simply reflect lags: it would take time to see the effects of a US-related slowdown here. Evidence of these effects might now be beginning to emerge. Two-thirds of the firms questioned in a survey by the Bank's Agents had revised down their expectations for exports to the United States (although these downwards revisions were partially offset by stronger expected growth in exports to other markets). That survey suggested that expectations of output growth, and to a lesser extent investment intentions, had also

been revised down. Large firms with US parents and those in the information and communications technology sector were the most significantly affected. These results were in line with the latest figures for manufacturing export orders in the survey by the Chartered Institute of Purchasing and Supply (CIPS).

20 The slowdown in the world economy would place pressure on the externally traded sectors of the economy, including manufacturing, particularly given the continuing resilience of the sterling exchange rate. For some members, this sharpened the policy dilemma. At some point, private sector domestic demand growth would need to slow to below trend. The longer this adjustment was delayed, the greater it might need to be. It could also involve a sharp fall in the sterling exchange rate.

21 In January, manufacturing output had fallen sharply, reflecting a fall in the output of the electrical and optical equipment sector, while in February it had risen by only 0.1%. And the CIPS manufacturing survey showed both output and orders falling sharply, to below 50 in both cases. These figures might in themselves point to somewhat weaker GDP growth than had earlier been expected. On the other hand, the business activity index for services, while also falling a little, remained well above the neutral 50 level, as did the equivalent series for construction.

22 Expenditure-based data suggested a somewhat stronger picture. In recent years, the initial output-based estimate of GDP has been subject to revision, generally in an upwards direction. In contrast to the prospective weakening of external demand, final domestic demand continued to grow strongly, and would be supported going forward by the public spending plans set out in the Budget. The new figures for business investment growth in Q4 were even stronger than the estimates made the previous month, and were consistent with continuing growth interrupted by a pause around the start of 2000. The implications of this strength for future capital spending were less clear.

23 In the February *Inflation Report*, consumption growth had been expected to moderate. In part this reflected an expected easing in the labour market (and so in real income growth) which had yet to happen. While consumption had grown by less than expected in 2000 Q4, at 0.6%, this might have been a result of weather and transport-related disruption. Retail sales volumes had increased by 1.6% on the latest three-month comparison, which of itself might suggest something of a rebound in consumption in Q1. While the GfK consumer confidence measure had risen slightly, the more recent

(and more volatile) MORI index had fallen sharply, perhaps reflecting the uncertainties caused by foot and mouth disease and the state of equity markets at the time of the survey.

24 For some, continuing strong growth in consumption remained an upside risk to the forecast, supported by the buoyancy of the money and credit figures and the pick-up in the housing market (both in terms of the quantities and prices data). The Royal Institution of Chartered Surveyors had noted a continuing increase in the balance of estate agents reporting rises in house prices, and provisional data indicated a further rise in March, although the forward-looking data suggested that the pace of increase in house prices might soon begin to moderate. The CBI Distributive Trades survey reported robust retail sales growth in March, coupled with significant increases for both wholesaling and the motor trades, although when sales were adjusted for the time of year, this strength was less apparent, and was not expected to persist into April. Meanwhile, total household wealth was estimated to have fallen by 4½% in 2001 Q1 (an estimate which included the effects both of higher house prices and lower equity prices). This reduced the upside risk to consumption and by itself might eventually reduce the level of consumption by ½%-1% over the medium term.

25 There were, as always, uncertainties about the outlook. In particular, there were downside risks from the slowdown in the global economy and the associated weakness of equity markets, both here and overseas, and also from foot and mouth disease. The last of these was difficult to quantify. Not only was it hard to predict the number of new cases which would emerge in the coming weeks and months, but there were also indirect effects (especially on tourism) and economy-wide effects (on business and consumer confidence) which were highly uncertain but could be significant.

26 The short-run effects on the agricultural sector were severe. Agriculture itself accounted for less than 2% of GDP, with the livestock sector closer to ½% of GDP. The effect would be to reduce both demand and supply in the agricultural sector. As a result, the direct impact on inflation from lower agricultural output was likely to be small.

27 The indirect effects, both on businesses further up the supply chain and on tourism and confidence more widely, would tend to reduce demand relative to supply. However, the size of these effects was hard to gauge, and would depend on the extent of any substitution effects. For instance, would those from the United Kingdom who decided not to visit the countryside nevertheless spend as much as originally planned on other UK goods and services? If so, this would have no

implications for aggregate UK consumption. However, such a shift in the geographical pattern of expenditure might exacerbate existing regional imbalances, which could conceivably have implications for the outlook for inflation, and hence for policy. There might also be changes in the timing of expenditure. By contrast, if overseas visitors chose not to visit the United Kingdom, or if UK residents holidayed overseas, the effect on demand would be unambiguous: UK GDP would be lower than otherwise, with a more negative contribution to growth from net trade and hence weaker inflationary pressures.

28 Whatever the impact of the foot and mouth outbreak in the short term, most members of the Committee thought that unless the tourism and confidence effects proved greater and more persistent than at present seemed likely, the impact into next year would be relatively moderate.

The labour market

29 Quantities data in the labour market were once again relatively buoyant. Employment was growing faster than the population of working age, after several months in which the Labour Force Survey (LFS) data had shown a weaker picture, perhaps as a result of travel and weather-related disruptions in autumn 2000. Unemployment continued to fall, both on the LFS and claimant-count measures; the LFS measure had declined to 5.2% in the three months to January, while the claimant-count measure showed unemployment below one million in February 2001 for the first time in over 25 years. When taken together with the CIPS surveys, and a small fall in the inactivity rate, there was little sign of any easing yet in the labour market.

30 Forward-looking indicators, however, were rather more mixed. The Report on Jobs from the Recruitment and Employment Confederation (REC) pointed to continued increases in permanent placements in March, but at the slowest rate for two years. The index of national press recruitment advertising was down on a year ago. Nevertheless the REC survey concluded that the labour market remained tight by historical standards, with widespread staff shortages. The Bank's regional Agents reported that while the labour market remained tight in most parts of the country, there were early signs of an easing in a few sectors.

31 The Committee agreed that despite the tightness in the labour market, there was little indication so far of any worrying increase in settlements and earnings growth. Month-by-month figures for

average earnings remained erratic, especially when compared with the figures a year ago which had been distorted by millennium-related payments. But the drift up in regular pay increases (particularly in the private sector which had moved from 4.3% in July to 4.9% in December), now seemed to have stopped. The figure for December had now been revised down to 4.8% and that for January was 3.9% (although this was distorted by the comparison with a year ago). There were therefore some signs that the rate of unemployment which was consistent with stable earnings growth was lower than previously believed. Nevertheless, the Committee would continue to monitor pay growth carefully, particularly given that April was a heavy month for settlements.

Prices and costs

32 There would be several erratic influences on RPIX inflation in the coming months, associated with the timing and nature of the Budget measures, movements in utilities prices last year, and the impact of foot and mouth disease. While it was possible that these might net out month by month, this could not be assured, and the data would therefore need to be interpreted accordingly.

33 Some members noted that if the components of RPIX were weighted together on the basis of their past persistence (with the aim of adjusting for erratic movements) rather than their importance in household budgets, the resulting measure of 'core' inflation was around 1.5%, and was projected to remain there for the next year. Others observed that the standard errors around such forecasts were large, and had reservations about using this technique, particularly to project inflation more than a few months ahead.

34 The Bank's regional Agents reported that prices continued to be restrained by competition and consumer pressure, although a few more companies had managed to increase prices modestly over the past month. But the CIPS surveys suggested diminished price pressures, with input costs in manufacturing rising at their slowest rate for 20 months and in services for 18 months. Output prices showed a similar picture. In services these prices had risen at their slowest rate for 18 months, while in manufacturing, prices had fallen for the first time since the series began in November 1999. Meanwhile manufacturing output prices excluding excise duties had risen by only 0.9% in the year to February.

The immediate policy decision

35 All members agreed that the prospects for the world economy now appeared rather weaker than at the Committee's previous meeting, and that the associated fall in equity prices would also restrain demand. Taken together with the short-run effects on demand and supply from foot and mouth disease, the downside risks to UK growth this year had increased. At the same time, price and cost pressures continued to be subdued, both in product and labour markets. The differences in view were mainly about the scale of the downside risks. Against this background, it was agreed that a reduction in the Bank's repo rate was needed this month to meet the inflation target; the question was how large that reduction should be.

36 For most members, the repo rate should be reduced this month by 25 basis points. While recognising the downside risks from the international slowdown, the fall in equity prices and foot and mouth disease, and while agreeing that it was important to remain forward looking, it was equally important not to over-react. Final domestic demand growth remained robust. The strength of the housing market would cushion the effects on consumption of falls in equity prices. Nor were there signs of weakness in business investment and government consumption; indeed, the reverse. The buoyancy of the money and credit aggregates, together with a labour market which was if anything continuing to tighten, suggested an upside risk to demand and inflation. Against this background, a greater-than-expected cut in interest rates at a time of fragile confidence could even prove to be counterproductive, by implying that the prospect for the UK economy was seen to be worse than it was. Lowering interest rates too far also risked exacerbating the imbalances between a strong domestic sector and weak net trade, imbalances which at some point would need to be resolved. The balance of risks, when taken together with the still moderate increase in earnings growth and subdued retail price inflation, suggested that a 25 basis point reduction in the repo rate was appropriate this month. All of these members agreed that the downside risks would need to be monitored carefully, and some of them felt that it might not require much additional downside news to justify a further cut in rates.

37 On a second view, although the decision was very finely balanced, it was better to reduce the repo rate by 50 basis points this month. While agreeing with the factors cited for a reduction in the repo rate, the continuing weakness of inflationary pressures against a background of significant downside risks, particularly the risk of a deterioration in confidence, argued for going further than

25 basis points. With price pressures remaining restrained month after month, it seemed less probable that inflation would pick up to the target of 2½% during the next two years without further action on interest rates. Sterling had not fallen back and this, together with competitive pressures, price resistance from consumers and the benefits from the application of information and communications technology, was continuing to help restrain inflation. Most measures of domestically generated inflation were now below 2½%. It was of course possible that a 50 basis point cut in rates might damage confidence, but it was just as likely that a pre-emptive reduction would help to sustain it. For these reasons, and as an insurance against the downside risks, the repo rate should be reduced to 5.25% this month.

38 On a third view, the decision to reduce the repo rate by 50 basis points this month was more clear-cut. In March, members taking this view had voted for a reduction in the repo rate of 25 basis points. More was now required; a 50 basis point reduction was not large either in the UK context or by comparison with movements elsewhere and, if properly explained, might help bolster confidence rather than dent it. These members had already been more pessimistic about the global economy than the central projection in the February *Inflation Report* and the recent news, together with developments in financial markets, had reinforced these concerns. Foot and mouth disease would impact on tourism from overseas (already suffering from the US slowdown and the strong exchange rate); in addition, the impact on confidence among those in rural areas might be neither small nor brief. Despite the strength in some backward-looking series, many forward-looking indicators were beginning to turn down. At the same time, on some measures policy remained contractionary, with real interest rates still slightly above their ‘neutral’ level and the lagged effects of past exchange rate and interest rate movements tightening conditions a little further this year. A ‘persistence-weighted’ measure of RPIX inflation was running at around 1½% and was likely to continue to do so for the rest of the year. Input and output price pressures seemed to be weakening still further, and RPIX inflation continued its slow and steady decline, to further below the target. Without further cuts in interest rates the recovery in inflation to 2½%, as set out in the February *Inflation Report*, seemed increasingly unlikely, depending as it did on estimates of capacity utilisation indicating that current output was above full capacity. This was not consistent with survey data or with different conceptual approaches to the measurement of capital inputs. Imbalances in the economy, such as those between domestic demand and net exports, might eventually cause problems but these, given the Committee’s remit, were secondary to the need to meet the inflation target. A 50 basis point reduction in interest rates was therefore needed this month to help sustain domestic

demand and improve the prospects of returning inflation to target. It was possible that further reductions would be needed in future months, even in the absence of further downside news.

39 The Governor invited members to vote on the proposition that the Bank's repo rate should be reduced by 25 basis points to 5.5%. Six members of the Committee (the Governor, Mervyn King, David Clementi, Christopher Allsopp, Charles Bean and Stephen Nickell) voted for the proposition. DeAnne Julius, Ian Plenderleith and Sushil Wadhvani voted against, preferring a reduction in the repo rate of 50 basis points.

40 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
Charles Bean
DeAnne Julius
Stephen Nickell
Ian Plenderleith
Sushil Wadhvani

Andrew Turnbull was present as the Treasury representative.

ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF

A1 This Annex summarises the analysis presented by Bank staff to the Monetary Policy Committee on 30 March 2001, in advance of its meeting on 4-5 April 2001. At the start of the Committee meeting itself, members were made aware of information that had subsequently become available, and that information is included in this Annex.

I The international environment

A2 The spot price for Brent crude oil had fallen by just over \$1 since the Committee's previous meeting, to around \$25 per barrel. The *Economist* industrial commodity index had fallen by 1.4% in March. The *Economist* soft commodity price index had also fallen (by 1.7%) in March, due to weaker coffee and sugar prices. World industrial production growth had slowed to 3.3% in the year to January, from 4.2% in the year to December. Consensus growth forecasts for 2001 had been revised down in March by 0.1 percentage points for the United States (to 1.9%) and the euro area (to 2.7%), and by 0.2 percentage points for Japan (to 1.2%).

A3 In the United States, post-tax profits had fallen for the first time in six quarters in Q4, but the fall had been exaggerated by settlements of legal claims by tobacco firms. The latest Senior Loan Officer Survey had shown that credit conditions had tightened further between January and March. The survey had shown falling demand for funds, which had been driven mainly by reduced capital expenditure. But aggregate lending data had shown that bank lending to firms continued to strengthen in February. Orders growth in capital goods (excluding erratics) had remained on a downward trend in February.

A4 Business inventory growth had continued to slow in January. Slower growth had also been indicated by the National Association of Purchasing Managers inventory component, which had remained below its historic average for the previous six months. Industrial production had fallen further in February. Industrial capacity utilisation in February had dropped to its lowest level since 1992. Manufacturing output had decreased by 0.5% on the month in February, and high-tech production growth had slowed further.

A5 Households' net financial wealth had fallen by 5.7% in 2000 Q4, reflecting falls in the value of equity holdings over that period. Both the Conference Board and the Michigan measures of consumer confidence had picked up in March. Retail sales had fallen in February by 0.2% in nominal terms, but the monthly growth rate in January had been revised up to 1.3% (from 0.7%). Real consumption had risen 0.1% in February, following a rise of 0.6% in January. Total non-farm payrolls had continued to grow in February, with strong growth in service sector employment offsetting falls in the manufacturing sector. But initial unemployment claims had increased in February and March after a dip in January.

A6 Annual consumer price inflation had fallen to 3.5% in February from 3.7% in January, reflecting a fall in energy prices. In contrast, core inflation, which excluded food and energy, had increased to 2.7% in February from 2.6% in January. Annual growth in hourly earnings had increased to 4.1% in February from 4.0% the month before. Core producer price inflation had fallen to 1.3%, following a sharp pick-up in January to 2.0%. The Federal Open Market Committee had reduced policy rates by 50 basis points to 5.0% on 20 March.

A7 In the euro area, GDP had grown by 0.7% in Q4, taking growth in 2000 to 3.4%. Industrial production had fallen by 1.9% in January after having risen by 1.7% in December. The IFO index for western Germany had fallen to 94.9 in February from 97.5 in January. Sub-indices on the assessment of the current business situation and business expectations had both fallen in February. German manufacturing and foreign orders had declined by 3.0% and 6.1% respectively in January. Industrial confidence had fallen slightly in March in the euro area, while consumer confidence had remained unchanged on the month. January and February data on French consumer spending on manufactured goods had pointed to robust consumption growth there in Q1.

A8 HICP inflation in the euro area had increased to 2.6% in February from 2.4% in January. Core inflation (excluding energy, food, alcohol and tobacco) had remained unchanged at 1.7%. Preliminary German consumer price inflation had fallen to 2.4% in the year to March from 2.5% in the year to February. Euro-area producer price inflation had fallen to 4.4% in February from 4.8% in January.

A9 Japanese GDP growth had been 0.8% in Q4 and 1.7% in 2000 as a whole. Private investment contributed 1.2 percentage points to GDP growth in Q4. Corporate profits had risen by 32% in the

year to Q4. The March Tankan survey had shown that corporate confidence had declined since December. Confidence among large manufacturers had declined by 15 points, from +10 to -5. Investment indicators had turned down in January. Industrial production had risen by 0.4% in February, having fallen by 4.2% in January. Japanese export volumes had declined by 5.7% in the year to February. Import volumes had remained resilient, and had grown at 2.8% over the year. Real wages had risen by 2.9% (seasonally adjusted) in the year to January, following an increase in winter bonuses. Retail sales had recovered in February, and had risen by 3.3% over the year in nominal terms and by 1.7% over the year in real terms.

A10 Domestic wholesale prices had declined by 0.4% over the year in February (compared with a fall of 0.3% in January). Overall wholesale prices had risen by 0.1% in February (from +1.2% in January). The Bank of Japan had changed the main operating target for money market operations from an uncollateralised overnight call rate to the outstanding balance of the current accounts held by financial institutions at the Bank of Japan.

A11 Most emerging markets' sovereign bond spreads had risen since the Committee's previous meeting. In Argentina the spread on dollar-denominated sovereign debt had risen by about 160 basis points.

II Monetary and financial conditions

A12 The twelve-month growth rate of notes and coin had been unchanged at 8.2% in March.

A13 M4 had risen by £2.1 billion (0.2%) in February, lowering the twelve-month growth rate slightly to 9.0%. The twelve-month growth rate of M4 excluding other financial corporations (OFCs) was unchanged at a post-December 1997 peak of 7.5%. The twelve-month growth rate of aggregate M4 lending (excluding the effects of securitisations) had fallen slightly to 12.5%.

A14 The twelve-month growth rate of household M4 had risen to 7.2% in February, the highest since February 1998. Following relatively weak outturns in early 2000, some recovery in household M4 had been expected as households sought to rebuild their deposits. Within total lending to individuals, the twelve-month growth rate of net secured lending had risen slightly to 8.3% in February, while that of unsecured lending had slowed to 11.8%, the lowest figure since

February 1995. The Bank's estimate of mortgage equity withdrawal in 2000 Q4 had been revised up to £2.8 billion from a preliminary estimate of £2.4 billion. The number of loan approvals had fallen by 10,000 in February from the strong figure seen in January, but remained robust by recent standards.

A15 The one-month flow of private non-financial corporations' (PNFCs') M4 had been negative in February, bringing the twelve-month growth rate down to 8.4% from 10.6% in January. The twelve-month growth rate of PNFCs' borrowing (excluding securitisations) had fallen to 13.5%. Total external finance had risen slightly, to £6.0 billion in February. The twelve-month growth rates of OFCs' M4 and M4 lending (excluding securitisations) in February had been 14.2% and 18.8% respectively.

A16 Short-term forward interest rates, as measured by the two-week gilt repo curve, had fallen significantly since the Committee's previous meeting. Most survey-based measures of short-term inflation expectations had fallen in March. The Consensus Economics and HMT surveys for RPIX inflation in 2001 had both fallen to 1.9%, the lowest level since 1997. The Barclays Basix survey of RPI inflation expectations by the general public over the next twelve months had also fallen sharply, to 3.5% from the 4.1% level seen the previous quarter. One year inflation forward rates inferred from the gilt market had fallen at short maturities, but had risen at medium maturities.

A17 At long maturities, both nominal and real yields had risen earlier in the month, possibly as a result of the announced abolition of the Minimum Funding Requirement. Over the month as a whole, nominal yields on maturities of up to eight years had fallen, while yields at medium and long maturities had risen. Real yields had also risen at medium and long maturities. Swap rates had moved broadly in line with yields on government debt. Issuance of non-gilt sterling-denominated bonds had fallen from last month's strong levels; issuance by UK companies had been particularly low in the fixed-rate category.

A18 Most variable retail rates had fallen in March, reflecting the reduction in the Bank's repo rate. The standard variable mortgage rate (SVR) had fallen even further, by a total of 44 basis points, as the cuts announced by a number of leading mortgage lenders had taken effect.

A19 Since the Committee's previous meeting, the sterling exchange rate index (ERI) had risen by 0.5%, to 105.0 at the close of business on 4 April. Sterling had been 1.9% lower against the dollar, and 0.8% higher against the euro. Changes in nominal interest rate differentials could not account for sterling's movements against these currencies.

A20 Equity markets had been turbulent since the Committee's previous meeting. With the exception of the Nikkei 225, all major indices had registered significant declines. Among these, the FTSE All-Share had fallen by 8.2%, the S&P 500 by 12.6% and the Dow Jones Euro Stoxx by 8.4%. In contrast to previous months, the declines had been widespread and not concentrated in technology sectors. Greater market uncertainty had been reflected in increased volatilities implied by options prices. Options prices had suggested that market participants' expectations were skewed towards further downward movements in equity prices in the United States, but not in the United Kingdom. The number of profit warnings issued by UK companies had remained high compared with a year ago and had been distributed across a range of sectors. A number of firms had cited slower US demand and foot and mouth disease as the reasons behind their announcement.

A21 Credit spreads on higher-quality US and UK corporate debt had changed little since the Committee's previous meeting. Those on lower-rated US corporate debt had widened in March, following declines seen earlier in the year. Indices on lower-rated corporate debt in the United Kingdom suggested that credit spreads had been broadly stable during March.

III Demand and output

A22 In the National Accounts, quarterly real GDP growth had been revised up to 0.4% in Q4 from 0.3% in the previous release. Annual growth had also been revised up slightly, to 2.6% from 2.5%. In addition, revisions back to the beginning of 2000 had resulted in the level of GDP being 0.1% higher in Q4. The revisions had smoothed GDP growth in 2000: growth in Q1 had been revised up to 0.4% from 0.3%, and growth in Q2 revised down from 1.0% to 0.9%. The output-based measure of growth had been rather weaker than the expenditure and income-based measures in Q4.

A23 On the expenditure side of the accounts, quarterly final domestic demand growth had been revised up to 0.9% in Q4 from the initial estimate of 0.7%. This had largely reflected an upward revision to whole-economy investment growth.

A24 Household consumption growth in Q4 had been revised down slightly to 0.6% from 0.7%. Within this, growth in spending on services had been weak but spending on durables had grown strongly.

A25 Government consumption growth in Q4 had been revised up slightly, to 0.3% from 0.2%. Growth in whole-economy investment had been revised up to 2.6% in Q4 from 1.2%, and the level of investment in Q4 was 1.2% higher than in the previous release of GDP. Business investment growth had been very strong in Q4 at 5.2%, but investment in dwellings and general government investment had both fallen.

A26 In Q4, the contribution to GDP growth from stockbuilding had been revised down to -0.7 percentage points from -0.6 percentage points. However this was more than accounted for by the alignment adjustment, which had subtracted 0.8 percentage points from growth in Q4.

A27 Revisions to export and import growth in Q4 had resulted in the net trade contribution to GDP growth being revised down slightly to 0.1 percentage points, from 0.2 percentage points in the previous release. Total exports of goods and services had risen by 2.3%, while imports had grown by 1.7%. The current account deficit had narrowed slightly in Q4 to £3.7 billion, compared with £4.0 billion in Q3.

A28 Households' nominal post-tax income had grown by 3.5% in Q4. The saving ratio had risen to 5.5% from 3.4% in Q4, although it had been thought that this partly reflected the timing of government winter fuel allowance payments. In contrast, the PNFCs' gross operating surplus had fallen by some 4.1% in Q4, compared with a rise of 3.1% in Q3. Excluding the alignment adjustment, the gross operating surplus had declined by 0.6% in Q4.

A29 Turning to Q1, retail sales had risen by 0.6% in February, increasing the three monthly growth rate to 1.6%. The GfK measure of consumer confidence had risen marginally in March, to +3 from +2 in the previous month, but the MORI measure had declined sharply to -29.

A30 Staff had updated their analysis of the impact of foot and mouth disease on 2001 Q1 and beyond. The estimated impact depended on estimates of both direct and indirect effects. It had been

thought that the main indirect effect would be through the impact of foot and mouth disease on tourism. But the precise impact would depend on the size of substitution effects.

A31 The Halifax and Nationwide house price indices had risen by 0.4% and 1.4% respectively in March. On the activity side, particulars delivered had increased sharply to 117,000 in March, the highest level since August 2000. The Royal Institute of Chartered Surveyors' price balance had risen by 7 points to +32 in February.

A32 Total industrial production had fallen by 0.3% and manufacturing output had grown by 0.1% in February. Output in the energy sector had fallen by 2.1%, reflecting declines in both the mining and utilities sectors.

IV The labour market

A33 Employment had grown by 102,000 (0.4%) in November to January compared with the previous three months, according to the Labour Force Survey (LFS). This rise in employment contrasted with falling employment in the previous two overlapping quarters. It was consistent with the unwinding of the effects of recent erratic factors including unusually wet weather and travel disruption in the autumn.

A34 Workforce Jobs had risen by 48,000 in Q4, continuing the recent pattern of slower growth than shown by the LFS data. The sectoral breakdown of Workforce Jobs had suggested that growth continued to be concentrated in (but spread across) the services sector.

A35 Survey evidence had suggested that employment continued to grow steadily in Q1 and that skill shortages had shown little change overall. The Chartered Institute of Purchasing and Supply (CIPS) survey indicated further expansion in construction and services employment in February, while manufacturers reducing employment still outnumbered those increasing employment. The CBI/Deloittes survey of business and consumer services had shown little change in either professional or clerical shortages.

A36 Average hours had risen by 1.1% in the three months to January and were now 0.4% higher than a year ago. Average full-time hours had increased by 0.9% and average part-time hours had

increased by 1.2%. It was possible that this increase partly represented catch-up after the autumn disruptions. Total hours worked had increased by 1.4% in November to January compared with the previous three months, having fallen in the autumn.

A37 The LFS measure of unemployment had fallen by 81,000 in November to January, pushing the rate 0.3 percentage points lower to 5.2%. The fall in the unemployment rate had been concentrated among the short-term unemployed (down 53,000 in the quarter). Claimant unemployment had fallen by 40,900 over the three months to January compared with the previous three months and by a further 10,600 in February. This had taken the claimant count below one million for the first time since December 1975.

A38 The working-age inactivity rate had risen by 35,000 in the three months to January, lowering the rate by 0.1 percentage points to 21.1%. This rate had been broadly the same as three months ago, but down sharply from Q4.

A39 Headline annual earnings growth, a three-month average of the actual rate, had been 4.4% in January, unchanged from December. Headline earnings growth in the public sector had fallen by 0.1 percentage points to 3.8%, while in the private sector it had been unchanged at 4.5%. Actual whole-economy earnings growth in the year to January had fallen sharply, to 3.9% from 4.8% in December, with this decline largely accounted for by a similar decline in the regular pay component from 4.6% to 3.8%. This could partly have reflected payments associated with working over the millennium date change dropping out of the comparison.

A40 The annual growth of wages and salaries per head had risen by 0.1 percentage points in Q4, to 4.3%. Annual growth in productivity, based on the Workforce Jobs measure of employment, had fallen by 0.3 percentage points (from a revised rate of 2.5% in Q3). Annual growth in whole-economy unit wage costs had picked up slightly in Q4, to 1.8%.

A41 The Bank's twelve-month AEI-weighted mean pay settlement figure had been unchanged at 3.1% in February. Public and private sector means had also been unchanged. The whole-economy three-month mean settlement had risen by 0.1 percentage points to 3.3% in February.

V Prices

A42 The Bank's oil-inclusive commodity price index had risen by 3.2% in February, taking its annual inflation rate to 7% in February from 6.9% in January. The monthly rise had mainly been accounted for by rises in the prices of fuels. The fuels component of the index had risen by 5.6% in February, which had largely reflected a rise of around 9% in the monthly average sterling oil price. The sterling oil price had weakened by around 7% in March. Although spot gas prices had fallen by around 30% from their peak in December 2000, they remained about 90% higher than a year ago.

A43 Manufacturing input prices had risen by 1.8% in February, but due to base effects the annual inflation rate had fallen to 6.1% in February from 6.9% in January. The CIPS input price index had fallen to 52.0 in March from 54.8 in February. Output prices excluding excise duties (PPIY) had fallen by 0.1% in February. Annual PPIY inflation had fallen to 0.9% in February from 1.2% in January, the lowest rate since September 1999. Looking ahead, the CBI manufacturing output price balance had been unchanged at -14 in March.

A44 The National Accounts release had contained revisions to GDP deflators back to 2000 Q1. The quarterly change in the GDP deflator at market prices in 2000 Q4 had been unrevised at 0.3%, although other revisions had raised the annual inflation rate to 1.2% (from 1.1%). The annual inflation rate of the GDP deflator at factor cost had fallen to 1.2% in 2000 Q4, after being revised up to 1.8% in 2000 Q3 (from 1.3%). The annual inflation rate of the household consumption deflator in 2000 Q4 had been revised down slightly to 0.7% (from 0.8%). Annual growth in the investment deflator in 2000 Q4 had also been revised down, to 0.3% (from 1.0%). In contrast, the government expenditure deflator had been revised up in the last three quarters of 2000, leaving it 0.9% higher in 2000 Q4 than it had previously been. The annual inflation rate of the import price deflator in 2000 Q4 had been revised down to 2.6% (from 2.9%), while the annual inflation rate of the export price deflator had been revised up to 2.3% (from 2.2%).

A45 RPIX inflation had risen by 0.1 percentage points to 1.9% in February. Both goods and services price inflation had risen by 0.1 percentage points in February, although the main contribution to the monthly rise had been from the housing depreciation component of the index. Looking ahead, the effects of foot and mouth disease on retail prices were highly uncertain. Data from the Meat and Livestock Commission had suggested that retail meat prices had risen by around

8% between the February and March RPI collection dates but had since begun to fall back. RPI inflation was unchanged at 2.7% in February, while RPIY inflation had risen by 0.1 percentage points to 1.6%. HICP inflation had fallen by 0.2 percentage points to 0.8%, thus widening the gap between it and RPIX inflation.

VI Reports by the Bank's Agents

A46 Manufacturing contacts had continued to report further moderate growth in output and orders. However, there had been more widespread evidence of a slowing in orders in the information and communications technology (ICT) sector. The Agents had reported that manufacturing contacts were becoming increasingly uncertain about the impact of the downturn in the US economy on manufacturing activity in the United Kingdom.

A47 The Agents had conducted a survey of around 170 firms (around one third of which had US parents) regarding the extent to which they had revised their expectations of growth in exports, output and investment since the beginning of the year as a result of the slowdown in the United States. A net balance of around two thirds of firms (weighted by turnover) reported that they had revised down their expectations for exports to the United States, although the majority reported that expectations had been revised down only slightly. While the overall net balance was similar for those firms with US parents, the responses had included a significantly higher proportion of firms reporting that expectations had been revised down 'significantly'. By sector, responses from the ICT industries had recorded the largest downward revisions. The responses had been more optimistic for total exports. But although the results had implied that growth in other export markets had been revised up, the overall balance remained negative. Expectations of output had also been revised downwards, by a similar extent to exports. Investment intentions had been least affected, although the balance of respondents also suggested that they had been revised down slightly.

A48 Contacts had reported a strong pick-up in construction activity in recent weeks, making up for delays due to poor weather in earlier months. Most contacts had continued to suggest that underlying confidence and expectations regarding future construction activity remained robust. Moreover, some Agencies had noted that earlier expectations of a pick-up in public sector construction were now beginning to be realised.

A49 Growth in business services had remained strong in almost all regions, although growth continued to slow from the beginning of the year, mostly as a result of weaker corporate finance and telecommunications activity. Growth in consumer services had also eased slightly. Reports from tourism-related contacts in some areas had suggested a downturn in activity in recent weeks as a result of foot and mouth disease. Many contacts were particularly concerned that demand from overseas visitors could be affected for some time.

A50 Comments from farming contacts had been dominated by the impact of foot and mouth disease. Many Agents mentioned that signs before the outbreak that confidence in the sector was beginning to improve had now been reversed. In addition to the direct impact on meat production, Agencies reported that many businesses further up the supply chain had been significantly affected (such as abattoirs, hauliers, feedstock suppliers, etc).

A51 Materials cost inflation had continued to ease back recently, though there had been more reports of concerns regarding administrative/regulation costs. In most cases, manufacturing output prices were now broadly flat, although there had been increased reports of price increases by some firms.

A52 Although conditions in the labour market had remained tight, some Agencies had noted early signs of an easing in shortages in some sectors. Despite continued upward drift in some wage settlements, most contacts had suggested that the total wage bill remained under control. Recent comments had suggested that the overall impact at a national level of the announcement of a 10% rise in the national minimum wage from October was likely to be small.

VII Market intelligence

A53 Expectations of official interest rates, as implied by short sterling futures, had fallen sharply since the Committee's previous meeting, by around 30-45 basis points. This reflected the slowdown in the world economy, and in particular the United States, together with falls in equity prices both in the United Kingdom and overseas, weaker-than-expected average earnings data and the uncertain impact of foot and mouth disease on the UK economy. Some market participants were now expecting official rates to fall to 5% by 2001 Q3. A similar picture emerged using forward interest rates implied by gilts. But while traders seemed to be expecting a reduction of 25 basis points at the

Committee's next meeting, a recent Reuters survey of interest rate expectations suggested that private sector economists' views on the future path of UK official interest rates were more diverse. Although forecasts for the level of official rates had softened slightly since the previous survey, economists attached a mean probability of only just over 50% to a rate reduction at the Committee's April meeting.

A54 The sterling ERI had been broadly stable since the Committee's previous meeting, rising by 0.5% to 105.0. Implied volatilities were now at their lowest level since January 2000. The slight appreciation of the sterling ERI had coincided with a depreciation of the euro against the dollar. The dollar had remained strong (the dollar ERI was now at its highest level since 1986) despite falls in US official interest rates and a decline in both the volume and value of cross-border mergers and acquisition activity. More recent data had suggested that US equity markets were still experiencing net capital inflows, although at a more moderate pace than during 2000 Q4.