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MINUTES OF
MONETARY POLICY COMMITTEE MEETING
5 and 6 June 2001

These are the minutes of the Monetary Policy Committee meeting held on 5 and 6 June 2001

They are also available on the Internet (http://www.bankofengland.co.uk/mpc/mpc0106.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 4 and 5 July will be published on 18 July 2001.

MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 5-6 JUNE 2001

1 Before turning to its immediate policy decision, the Committee discussed the world economy; monetary and financial conditions; demand and output; the labour market; and prices and costs.

The world economy

2 While some of the latest data from the United States were perhaps better than might have been expected, the overall prospect remained broadly in line with the central projection in the May *Inflation Report*. The manufacturing sector was now plainly in recession, with a fall of 2% in output between the fourth quarter of 2000 and the first quarter of this year, and a further fall of 0.3% in April. The National Association of Purchasing Managers' (NAPM) index had weakened again in May. Non-farm payrolls were 19,000 lower in May, though the data for April had been revised somewhat and now no longer showed the fall in services sector employment which had suggested that the downturn might already have spread beyond the manufacturing sector. The index of total hours worked in April and May was, at an annualised rate, 1½% below its average for the first quarter, suggesting that output might be weakening. By contrast, the news on consumption presented a rather stronger picture and was surprisingly resilient given the manufacturing downturn. Consumer confidence had improved somewhat, the housing market remained fairly strong and the fiscal package - which would inject between $40 billion and $50 billion into the economy this year - had been agreed by Congress. The effects of the reductions in official interest rates since the turn of the year were still to feed through fully to the economy.

3 What these latest outturns might imply for the US outlook was less clear. It was encouraging that a sharper slowdown had not so far materialised, though it remained an open question whether the slowdown in the information and communications technology (ICT) sector would persist and become more widespread. Leading indicators of investment remained weak and the falls in ICT investment could, if sustained, have implications for the pace of future productivity growth. The slowdown had, however, had only a modest impact so far on household spending. This might be because households would respond less than had previously been thought likely, or because it was taking longer than expected for them to react to the falls in equity wealth since last autumn and the weaker labour market more recently. Alternatively, the speed of the Federal Reserve's action in cutting interest

rates could have been important in underpinning consumer confidence and so consumption: the slowdown in activity growth had been widely publicised, so it would be odd if consumers were to react to it only with a long delay.

4 There were some indications that consumption growth might yet slow: there was a slowing in the momentum of retail sales growth, and some members pointed to various labour market indicators (including employment intentions surveys and the Help Wanted index) as suggesting further weakness ahead. And if consumption growth did not slow, the question remained of how long the imbalances in the economy could persist. The external and domestic imbalances could be sustainable if the increase in the rate of productivity growth proved to be robust. If it did not, there was a risk that any adjustments might happen abruptly. But they could equally take place gradually, over a number of years. The implications for the United Kingdom in the near term were therefore unclear.

5 The Committee discussed the marked upward shift in yield curves in the past two months: yields at ten year maturities, for example, had risen by 43 basis points in the United States (and by almost as much in many other major economies). A number of possible explanations were put forward. Most of this shift in expected rates had been at the two-year horizon and beyond, and so was consistent with a market view that the slowdown would not be as severe as had at one time been feared. But market expectations of inflation and views about the future stance of policy might also be part of the story. A second possibility, therefore, was that inflation expectations had fallen to implausibly low levels earlier in the year, so the shift in yields could to some extent be seen as a market correction rather than as news about the likely shape and extent of the downturn. The spread between corporate dollar bond yields and those on US Treasuries had narrowed recently, so the expectations implied by corporate yields had risen rather less strongly. This change in spread might in part reflect revised market expectations of the relative supply of corporate and government bonds, in the light of the planned tax cuts.

6 Some members of the Committee suggested that the path of official US interest rates implied by the yield curve might be unrealistic, indicating as it did that rates would soon be cut to 3¾% but would be increased to 5% by early next year. But it was noted by others that such a path was not wholly implausible. It would be consistent with a V-shaped recovery in which the authorities might need to support business and consumer confidence in the short run but then dampen any unwarranted optimism in the upswing, particularly if some of the earlier cuts had been as insurance against

downside risks which in the event might not materialise.

7 It was nonetheless encouraging that the more gloomy expectation which had brought about the earlier falls in yields were no longer the dominant market perception, and that this recovery in sentiment had been sustained. The dollar remained strong, stock markets had been broadly stable and forecasts for growth in earnings per share for US companies in 2002 remained very buoyant.

8 The news on developments in the euro area was rather less encouraging. Growth in the first quarter was slightly weaker than had been expected at the time of the May *Inflation Report*, and domestic demand in Germany was slowing more quickly than expected. The Purchasing Managers' Index for the euro area as a whole was now below 50 and almost as low as it had been in 1998.

9 The slowdown in Germany was essentially domestic in its origins and had until recently been offset by a relatively strong net trade position. But the German net trade position was now weakening too, reflecting the slowdown in world trade which was also affecting the outlook for exports elsewhere in the euro area. Of perhaps greater concern were the signs of weaker consumer and business confidence in France, and weaker estimates of euro-area growth in the second quarter. In addition, the increase in inflation in the euro area would begin to erode growth in real personal disposable incomes, which would weaken consumption growth. It might also limit the scope for monetary policy action to sustain demand. Resilient consumption had helped offset the effects of the US slowdown and underpinned the Committee's projection for the euro area. So for some members the recent news suggested that the downside risks to the euro-area outlook had increased.

10 In Japan, the business sector remained weak and export volumes were substantially lower than a year ago. Signs of recovery there remained elusive.

Monetary and financial conditions

11 Growth of all the main monetary aggregates in the United Kingdom was slowing. But the main feature of the recent data was the marked contrast between the strength of household deposits and borrowing on the one hand and the relatively weaker corporate sector aggregates on the other. Total household borrowing, for example, had increased by nearly 10% in the year to April. Corporate deposits had increased by only 3½% in the year to April, down from 12% last autumn, and the

twelve-month increase in corporate borrowing from banks had slowed from a peak of nearly 17% in the third quarter of last year to just over 10% in April. This might appear to be consistent with a reversal of the recorded pick-up in investment growth in the fourth quarter: business investment growth in the first quarter had slowed, to 0.8%. But much of the slowdown in investment growth could in fact be attributed to weaker-than-expected non-business investment. On the other hand, corporate borrowing growth was hardly low: it had simply fallen back from very high rates. At the sectoral level, borrowing in the first quarter had been concentrated in the services sector, real estate and construction: the manufacturing sector had in aggregate been repaying debt recently. So it was difficult to draw any clear conclusions about general weakness in the corporate sector from these data. And though the number of profit warnings was greater than a year ago, this increase was smaller so far in the second quarter than it had been in the first. The extent of the downward skew in equity prices had also lessened, suggesting that the markets now attached a lower probability to falls in equity prices from their current levels.

12 Sterling was 2% higher in effective terms at the start of the Committee's meeting than it had been at its May meeting. This was however largely the result of euro weakness rather than of sterling strength: sterling had fallen to 1.40 against the US dollar. There seemed to be no convincing explanations for the dollar's continuing strength.

13 The overnight fall during the meeting (of about 1%) in sterling's value might, it was suggested, be related to market speculation about the possibility of speedy moves towards a decision on UK adoption of the euro after the General Election. Such speculation could, members thought, continue and lead to greater exchange rate volatility in the months ahead.

14 The Committee reflected on the recent robustness of house prices, notably as measured by the Halifax and Nationwide price indices and by the price balance from the survey carried out by the Royal Institution of Chartered Surveyors, and on the strength of the housing market more generally. The implications for the May *Inflation Report* forecast were unclear, because the DETR house price index on which it was based had risen rather less in the first quarter than had been assumed (so measured house prices might now be increasing faster, but from a lower level). Some members took reassurance from the fact that house prices were rising less fast in the southeast of England than in other parts of the country, as this implied that the latest increases at the aggregate level were the result of a return to more normal regional differentials rather than of a generalised pick-up in house price

inflation. It was possible that the housing market could become a source of further concern, if low levels of mortgage interest rates were to prompt a renewed house price boom. The recent data suggested that housing market activity and gains in real housing wealth were at least as strong as had been expected at the time of the May *Inflation Report* projections.

15 The financial markets attached little probability to a cut in interest rates this month and now expected that a low point would be reached in the third quarter. Implied interest rates at longer horizons had increased over the month.

Demand and output

16 GDP growth in the first quarter had been revised up slightly, bringing it into line with the assumption made as the starting point for the projection in the May *Inflation Report.* It seemed possible that it might be revised further in that direction, as there was accumulating evidence that construction output had been growing more strongly than was yet reflected in the official data.

17 But the first estimate of final domestic demand growth in the first quarter, of 0.5%, was below expectations and was not easy to reconcile either with the published output data or with other information. Consumption growth of only 0.6% in the first quarter, for example, was somewhat at odds with the strong growth in retail sales (up almost 6% year on year) and with car registrations data. Household spending on new cars in recent quarters might, however, be a misleading indicator of the underlying strength of this component of demand because of changes both to the pattern of sales during the year and to the share of sales accounted for by private purchasers. The strength of the housing market also suggested that consumption growth was stronger than was currently estimated. It was odd both that non-business investment should have fallen and - given output and other data - that investment should be so consistently strong across the manufacturing sector. It seemed reasonable to expect upward revisions to final domestic demand growth in the first quarter, largely matched by downward revisions to the contribution of stockbuilding to GDP growth, though some members thought that any revisions were still likely to leave estimated growth in final domestic demand below the level assumed in the May *Inflation Report* projection.

18 The Index of Production data for April, which became available to the Committee during its meeting, showed a further fall in production, with manufacturing output falling even more than had

been expected. The most marked fall was in the optical and electrical equipment sector.

19 Looking ahead, surveys presented a mixed picture. The Chartered Institute of Purchasing and Supply (CIPS) survey suggested that manufacturing output was falling, and the CBI survey that new orders were lower. Services seemed rather more robust, though the latest CBI/Deloittes survey showed falls in optimism in both business and - more markedly - consumer services. The CIPS survey for services had been weaker than for over 18 months. It was possible that this might in part be reflecting the impact of the foot and mouth epidemic on activity in the hotels sector. The survey by the British Retail Consortium, though suggesting a stronger outlook, tended to sample larger stores, some of which might benefit disproportionately from any change in spending patterns as a result of the foot and mouth epidemic. Some members were also concerned by the latest reports from the Bank's regional Agents, suggesting that the weakness in manufacturing was spreading to services, and by the results of the Agents' special survey of stockbuilding which suggested that further falls in stocks were likely over the next six months. Taken by itself, this implied continuing weakness in output growth which was consistent with recent National Institute estimates and with some surveys.

The labour market

20 There was little news on the labour market. On the quantities side, employment continued to grow faster than the population of working age; and unemployment to fall, in part because participation in the labour market was increasing less rapidly than had been expected. Though the projections in the May *Inflation Report* embodied an expectation that the market would soon begin to turn, there were few signs in the data that it had yet started to do so. Recent survey information suggested a rather weaker picture, but was still uniformly stronger than the surveys' historical averages. From the limited historical evidence, it was not at all clear how a market in which the employment rate was falling would be reflected in these surveys. Vacancies data had fallen a little, but remained very high. The latest CBI/Deloittes survey of the consumer and business services sectors showed that many firms, particularly in the latter sector, continued to report that staff shortages were a constraint on their expansion. In short, the labour market did not yet appear to be easing, although it might be tightening rather less fast.

21 Consistent with this picture, the underlying pace of earnings growth seemed to have edged up a little since last summer. This was clearest in the growth of regular pay, which had picked up again

after two months of slower annual growth, probably reflecting the higher level of regular pay a year earlier as a result of payments made for additional work over the millennium. Settlements too had turned out rather higher overall in the latest pay round than last year. If - as the output data suggested - the pace of growth was beginning to ease, then some easing in the labour market should in due course become apparent. That could in turn moderate the upward pressures on pay growth as well as affecting workers' perceptions of job security.

Prices and costs

22 The Committee noted that the price of oil had risen by about 8% since its previous meeting. There was little news in this about the prospects for the oil price, though the strengthening was perhaps consistent with market perceptions that the outlook for world activity was rather less weak than it had seemed a few months ago. The GDP deflator for the first quarter was rising somewhat faster. But this was volatile and subject to revision, so its quarterly movements were accorded little weight by most members in interpreting cost and price developments.

23 Some members drew attention to the recent surveys of businesses' price expectations, which had weakened significantly: the CIPS services input and output price series were at their lowest levels since October 1999 and the manufacturing input prices series below 50 for the first time since July 1999 - despite the recent pick-up in oil prices. A year ago, price expectations had been higher yet had been followed by somewhat lower-than-forecast RPIX inflation outturns. So to the extent that these surveys were indicative of pressures in the pricing chain, these members argued that they pointed to benign outturns in the coming year.

The immediate policy decision

24 There was general agreement in the Committee that the news on the month was, on balance, limited and did not resolve the uncertainties which had surrounded the prospects for inflation in the United Kingdom for some months. The slowdown in the United States was so far a little less marked than had previously seemed possible, but it remained unclear - despite the recent more optimistic expectations reflected in financial market prices - how long it would persist or how rapid the recovery would be. Activity in the euro area was perhaps a little weaker than expected at the time of the May *Inflation Report*, and there were signs that consumer confidence there and consumption itself were

now beginning to weaken.

25 In the United Kingdom, there was still little evidence that household consumption growth was easing: indeed, it seemed more robust than for some months. So with slower output growth and falling production, especially in the externally exposed sectors, the imbalances in the economy - which had been apparent for some time - were likely to persist. RPIX inflation was somewhat below target and projected to remain so for some quarters. If the dampening effects on inflation of the slowdown in world activity and the strength of sterling were to persist, that would have implications for inflation further ahead. Policy action to offset these effects would, however, tend further to stimulate consumption and so to worsen the imbalances. These could then prove more problematic for the control of inflation in the medium term. That was a key policy dilemma.

26 Against this background, most members felt that there should be no change in the repo rate this month. The news from the United States suggested that the risk of a significantly worse outcome than was included in the May *Inflation Report* projections was somewhat less than it had been, though it remained possible that the slowdown could be more prolonged than was currently projected. A range of factors provided these members with varying degrees of comfort about the prospects for the US economy: the latest US employment data and revisions to previous months suggested that job losses were slowing and were more concentrated than previously thought in manufacturing; the faster de-stocking now recorded in the first quarter could be consistent with a shorter-lived downturn; and the slowdown had so far had only a limited impact on the household sector. The financial markets now appeared to be less gloomy about the prospects than a few months ago. This change in market expectations was consistent with the latest data and to that extent seemed well-founded, though for some there were oddities in the implied path of official rates over the coming year. Some of these members were not yet convinced that a relatively early recovery of activity in the United States was the most likely outcome and regarded an investment slowdown as more likely to be associated with a slower recovery. If a worse outcome began to materialise, however, it would be possible for policymakers to react. Offsetting this somewhat more encouraging US prospect were the rather weaker-than-expected outturns in parts of the euro area. On balance, these members felt that the overall prospect for world activity was little changed on the month.

27 Domestically, too, there was little in the latest data which justified a change in the repo rate. The news on the month was mixed. UK final domestic demand growth in the first quarter had turned out

below the expectation embodied in the May *Inflation Report* and recent surveys were rather weak, suggesting a second quarter outturn that might also be below that projection. The sectors most exposed to the slowdown in world activity, to the strength of sterling and to the consequences of the foot and mouth epidemic were weak, but most of the non-tradeable sectors were robust. This apparent weakness in overall output growth contrasted, however, with the continued strength of consumption. This was reflected in strong growth in retail sales and relatively rapid growth in household borrowing, and underpinned by a pick-up in the housing market. The labour market remained tight and there was some evidence that underlying earnings growth had edged up a little since last summer. Employment prospects seemed unlikely to dampen consumer confidence. Looking further ahead, this strength of consumption growth and of sterling were sources of concern, as they would add to the imbalances in the economy. A further reduction in interest rates could bring inflation more quickly back to target, but it would at the same time tend to exacerbate these imbalances and so pose risks for the inflation outlook in the medium term. The uncertainties about both the current state of the economy and the possible risks to the outlook from the imbalances were sufficient to justify waiting for more information about how domestic demand would evolve.

28 On another view, the outlook for the UK economy remained weaker than the central projection in the May *Inflation Report* and the inflation outlook more benign. A reduction of 50, rather than 25, basis points had been justified last month, so a reduction of 25 basis points was warranted without any further news. In fact, the news on the month was slightly on the downside. Rapid recovery in the United States was by no means assured and the recovery in financial markets' confidence was from a very low base. There was no evidence of inflationary pressures in the US economy: capacity utilisation and price survey balances were falling and wage pressures were moderating. The financial markets now seemed to believe that the current investment-led downturn might be short-lived, but confidence in such an outcome was not encouraged by historical experience. The prospect for the euro area was also becoming a source of concern, with weakness now spreading beyond Germany and both business and consumer confidence in several euro-area countries showing signs of weakness. Domestically, the forward-looking indicators were weaker than expected. The UK services sector seemed weaker than for some time and the special survey on stock levels conducted by the Bank's regional Agents suggested that further de-stocking was in prospect. Forward-looking evidence on pricing suggested that businesses' price expectations had softened, and import prices in the first quarter were below expectations. While underlying earnings growth had strengthened and echo effects might keep earnings growth high in the near term, the likely impact of falling RPI

inflation on settlements and of weaker profits on bonuses should lead to weakening earnings growth later in the year. Consumption growth and the housing market were both stronger than expected and represented a key upside risk to the outlook. But overall, the news on the month was modestly on the downside. A further cut in rates was still justified, to help to achieve the inflation target in the medium term.

29 The Governor invited members to vote on the proposition that the Bank's repo rate should be maintained at 5.25%. Eight members of the Committee (the Governor, Mervyn King, David Clementi, Christopher Allsopp, Kate Barker, Charles Bean, Stephen Nickell and Ian Plenderleith) voted for the proposition. Sushil Wadhwani voted against, preferring a reduction in the repo rate of 25 basis points.

30 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 Wadhwani

The Treasury were represented by Andrew Turnbull on the afternoon of 5 June and by Gus O'Donnell on the morning of 6 June.

ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF

A1 This Annex summarises the analysis presented by Bank staff to the Monetary Policy Committee on 1 June, in advance of its meeting on 5-6 June 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 According to the Bank's preliminary estimates, world GDP growth had slowed to 2.4% in the year to 2001 Q1, from 3.4% in 2000 Q4, and world industrial production growth had slowed to 1.1% in the year to March, from 2.7% in the year to February. In the G3, growth of industrial production had continued to slow: in the United States to -0.9% in the year to April, from flat in March; in Japan to -3.8% in the year to April, from -1.5% in March; and in the euro area to 3.0% in the year to March, from 4.2% in February. Consensus growth forecasts for 2001 had been revised up for the United States, down for the euro area and had remained the same for Japan.

A3 The spot price for Brent crude had risen to around $29 per barrel, around $1 higher than at the time of the May MPC meeting. Since the May MPC meeting, the Economist Industrial Commodity Index had risen by 1.5%, led by non-food agricultural commodities, but the Economist Food Index had fallen by 0.7%.

A4 In the United States, GDP growth in Q1 had been revised down to 0.3% (from 0.5%). Consumption growth had been revised down to 0.7% (from 0.8%). Investment growth had been revised up to 0.6% (from 0.4%). Net trade had been revised down slightly, contributing 0.3 percentage points to quarterly growth, compared with 0.4 percentage points in the advance estimate. The smaller contribution of net trade had been due to a slight upward revision to import growth to -2.4% (from -2.7%). Export growth had been revised down slightly to -0.7% (from -0.5%).

A5 The latest Senior Loan Office Survey, conducted in May, had shown that bank credit conditions for corporate lending had continued to tighten, but that the net balance of banks raising standards had eased slightly. The survey also indicated that demand for funds by firms had weakened further. Post-tax corporate profits had declined by 1.9% in Q1. Manufacturing output had declined by 0.3% in April, and revisions to back data had shown the profile in Q1 to be weaker than before. The National Association of Purchasing Managers' Index had fallen to 42.1 in May from 43.2 in April. Non-farm business labour productivity had been revised down to show a fall of 0.3% in Q1.

A6 Household consumption had risen by 0.1% in April. The Conference Board measure of consumer confidence had risen to 115.5 in May from 109.9 in April. That increase had reflected strong gains in the forward-looking component. Non-farm payrolls had fallen by 19,000 in May, compared with a fall of 182,000 in April. The unemployment rate had declined to 4.4%. Initial unemployment claims had stabilised, albeit at a high level. Producer prices had risen by 3.6% in the year to April, compared with 3.1% in March. Core annual consumer price inflation had declined slightly, from 2.7% in March to 2.6% in April.

A7 In Germany, GDP had risen by 0.4% in Q1. Falling domestic demand had reduced growth by 0.4 percentage points and changes in inventories had reduced it by 0.2 percentage points. Net exports had contributed 1.0 percentage points growth. In France, GDP had risen by 0.5% in Q1. Domestic demand had contributed 1.0 percentage points to growth and net exports had contributed 0.3 percentage points. Changes in inventories had reduced growth by 0.8 percentage points. In Italy, GDP had risen by 0.7% in Q1.

A8 Euro-area consumer confidence had fallen to -4 in May from -2 in April on the EU Commission measure. Industrial confidence had declined to -5 in May from -4 in April. The west German IFO business confidence index had fallen again in April, reaching a level of 92.5, from 93.9 in March. German manufacturing orders had fallen by 4.4% in March.

A9 Euro-area producer prices had risen by 4.1% in the year to April, compared with 4.2% in March. German producer prices had risen by 5.0% in the year to April. Euro-area annual HICP inflation had risen to 2.9% in April, compared with 2.6% in March. Core HICP inflation had risen to 1.9%. Annual unadjusted M3 growth in the euro area had increased in April to 5.2% from 5.1% in March.

A10 Japanese industrial production had declined by 3.8% in the year to April. Tertiary activity had risen by 2.5% in the year to March. Export volumes had declined by 9.2% in the year to April. By region, exports to the United States had declined by 18.2%, exports to Europe had declined by 14.4% and exports to Asia had declined by 7.7%. Import volumes had risen by 1.6% in the year to April. Annual growth of industrial production and exports had also declined in Korea, Taiwan and Malaysia.

II Monetary and financial conditions

A11 The twelve-month growth rate of notes and coin had fallen to 7.1% in May and the three-month annualised growth rate had remained weak at 3.9%.

A12 The twelve-month growth rates of M4 and M4 excluding other financial corporations (OFCs) had fallen in April to 7.9% and 6.7% respectively. The twelve-month growth rate of aggregate M4 lending (excluding the effects of securitisations) had fallen in April to 11.1%. Excluding OFCs the figure was 9.8%.

A13 The twelve-month growth rate of household M4 had fallen slightly but had remained strong in April at 7.6%, while household M4 lending (excluding securitisations) had risen slightly to 9.6%. Within total lending to individuals, annual growth of net secured lending to individuals had remained virtually unchanged in April at 8.3%, while the growth rate of net unsecured lending to individuals had risen to 11.8%. Within unsecured lending, the annual growth rate of total credit card borrowing had fallen since the third quarter of last year, but the growth rate of the interest-bearing component of credit card borrowing had risen since the middle of the year. The Bank’s provisional estimate of mortgage equity withdrawal had risen from £2.8 billion to £3.2 billion in 2001 Q1. The number of loan approvals and particulars delivered had been little changed in April compared with March.

A14 The twelve-month growth rate of private non-financial corporations’ (PNFCs’) M4 had fallen substantially in April, to 3.4%. The twelve-month growth rate of PNFCs’ M4 borrowing (excluding securitisations) had also fallen in April, to 10.4%. PNFCs’ net recourse to the banking system had remained strong in April at £1.9 billion. Total external corporate finance had fallen to £2.2 billion in April. The twelve-month growth rates of OFCs’ M4 and M4 lending (excluding securitisations) in April had been 12.0% and 15.5% respectively, and had represented a marked slowdown in lending growth.

A15 Short-term forward interest rates, as inferred from prices of conventional gilts and general collateral repo contracts, had risen for all but the shortest maturities since the May MPC meeting. Forward rates had risen by 25 basis points at around two years, and had risen by around 40 basis points at all maturities over 15 years.

A16 Survey measures of the short-run inflation expectations of professional economists had been little changed in May. The Bank’s quarterly survey of public attitudes to inflation had shown that the general public’s expectation of inflation in 2001 had risen only marginally, to 2.2%. The GfK balance of cost of living expectations had remained high in May. Inflation expectations derived from a comparison of conventional and index-linked gilt yields had risen, particularly at longer maturities, since the May MPC meeting. Real yields derived from index-linked gilts had risen slightly since the May MPC meeting, a continuation of the previous month’s trend.

A17 Most variable retail rates had fallen in May, reflecting the April reduction in the Bank’s repo rate. The standard variable mortgage rate (SVR) had fallen by 25 basis points since April and had been expected to fall by a further 25 basis points in June. Short-term fixed rate mortgage rates had

also fallen in May, but by less than the SVR. Swap rates had moved broadly in line with yields on government debt. Savings rates had fallen broadly in line with cuts in the repo rate, but quoted unsecured loan rates had remained unchanged.

A18 Credit spreads on UK corporate debt had continued to decline since the Committee's previous meeting. Those on lower-rated corporate debt had fallen by the largest amount. Issuance of non-gilt sterling bonds had risen in May. Issuance by UK corporates had contributed significantly to this rise.

A19 The FTSE All-Share and FTSE 100 indices had risen by 0.8% and 0.5% respectively since the Committee's previous meeting. The FTSE 250 and Small Cap indices had risen by 2.6% and 1.5% respectively over the same time period. IT and non-cyclical services (mainly telecoms) had been the weakest sectors. Profit warnings had risen slightly in May. They had been higher than in May 2000, but lower than at the beginning of the current year.

A20 Between the Committee's May meeting, and 5 June the sterling exchange rate index (ERI) had appreciated by 2.1% to 107.7, and sterling had appreciated by 3.3% against the euro.

III Demand and output

A21 GDP growth in 2001 Q1 had been revised up to 0.4% (from 0.3%). The annual growth rate had been revised up to 2.6% (from 2.5%). Total industrial production had fallen by 0.7% in Q1. Within this, manufacturing output had fallen by 0.7%. Service sector output had grown by 0.8%, revised up from 0.7% in the preliminary release, reflecting strong growth in the output of transport and communication industries and a recovery in output of business services and finance. Construction output was estimated to have fallen by 0.5%. By contrast, DETR data published after the GDP release estimated that construction output had grown by 1.9% in Q1. Agricultural output had risen by 0.9%.

A22 The expenditure breakdown of GDP showed that domestic demand had grown by 0.8% in Q1. Final domestic demand had grown by 0.5%, as changes in inventories had contributed 0.3 percentage points to growth.

A23 Private sector consumption (including that of non-profit institutions serving households) had grown by 0.6% in Q1 and had increased by 3.2% in the year to 2001 Q1. Government consumption had risen by 0.1%. Total investment (including acquisitions less disposals of valuables) had increased by 0.7%. Business investment had increased by 0.8%. Within this, manufacturing investment had increased by 9.4%, while service sector investment had risen by 0.2%, down from growth of 6.5% in 2000 Q4. The gross operating surplus of corporations (including the alignment adjustment) had risen by 0.7% in 2001 Q1.

A24 Net trade had reduced GDP growth in 2001 Q1 by 0.5 percentage points. Total exports of goods and services had increased by 1.1% while imports had increased by 2.2% in Q1.

A25 Turning to indicators of activity in the second quarter, retail sales volumes had risen by 0.6% in April and by 1.4% in the three months to April on the previous three months. Private new car registrations in April had risen by 18% on a year earlier. The retail sales balance in the Confederation of British Industry (CBI) survey of distributive trades had risen slightly to +35 in May from +32 in April. The GfK measure of consumer confidence index had risen to +2.6 in May from +1.9 in April while the MORI measure had increased to -4 in May from -22 in April.

A26 The Halifax house price index had risen by 1.5% in May, while the Nationwide index had increased by 0.8%. Annual growth of the Halifax index had been 7.3% in May, while the Nationwide index had increased by 7.7%. The Royal Institution of Chartered Surveyors' (RICS) balance of estate agents reporting increased prices over the past three months had fallen back very slightly to +37 in April, from +39 in March. A preview of the RICS balance for May indicated a rise. The House Builders' Federation monthly survey had shown a net balance of housebuilders reporting an increase in house prices of +37 in April, up from +22 in March. Particulars delivered had fallen by 3,000 to 114,000 in April. But in the three months to April, particulars delivered had been 5.1% higher than in the previous three months.

A27 Total industrial production had fallen by 0.1% in April. Within this, manufacturing output had fallen by 0.9%. The manufacturing output expectations balance in the CBI Monthly Trends survey had remained unchanged at -2 in May. The total orders balance had remained weak though it had increased a little, to -24 in May from -26 in April. The headline index of the Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey had been 46.4 in May. The new orders index had fallen to 47.9 in May from 48.1 in April. The headline CIPS services survey balance had been 52 in May. The CIPS construction index had risen to 56.8 in May.

IV The labour market

A28 According to the Labour Force Survey (LFS), employment had risen by 100,000 (0.4%) in 2001 Q1. The working-age employment rate had increased by 0.2 percentage points and was 0.4 percentage points higher than a year ago. Average hours had remained unchanged in 2001 Q1, so total hours had increased by 0.4%.

A29 Survey evidence suggested that employment growth had slowed in Q2. The CIPS survey had shown a sharp slowing in April and this had been confirmed by the survey in May. The Recruitment and Employment Confederation survey had indicated a further slowing in the demand for permanent and temporary agency staff in May.

A30 LFS unemployment had decreased by 64,000 in 2001 Q1, which had taken the rate down by 0.2 percentage points from its Q4 level to 5.1%. The claimant count had fallen by 44,000 between Q4 and Q1, and by a further 10,200 in April. Inactivity, as measured by the LFS, had increased by 27,000 in 2001 Q1. The increase in inactivity had been more than accounted for by a rise in those saying they did not want a job.

A31 The Recruitment and Employment Confederation survey for May indicated that agencies had not reported any worsening in the availability of staff. The Bank's regional Agents also reported that shortages of skilled labour had not worsened further and in some respects had eased slightly.

A32 Annual whole-economy productivity growth on the Bank's LFS heads-based estimate had been 1.6% in 2001 Q1, a fall of 0.1 percentage points from 2000 Q4. The hours-based estimate of productivity growth had also fallen.

A33 Headline (three-month average) annual earnings growth had fallen by 0.1 percentage points to 5.1% in March. This fall had been accounted for by a 0.2 percentage point fall in headline earnings growth in the private sector to 5.4%. Actual earnings growth in the year to March had fallen by 2.1 percentage points from its temporarily inflated February level, to 4.4%. Annual private sector earnings growth had fallen by 3 percentage points to 4.3%; annual public sector earnings growth had risen by 1.3 percentage points to 4.3%.

A34 The annual growth rate of regular pay (not seasonally adjusted) had risen by 0.7 percentage points in March to 4.8%. The pick-up had been largest in private sector services and the public sector. Bonuses had made a negative contribution to earnings growth (not seasonally adjusted) in March, following a large positive contribution in February. The pattern of the bonus contribution over recent months had been affected by a number of firms in the financial services sector changing the month they had paid bonuses from March in 2000 to February in 2001.

A35 The Bank's twelve-month AEI-weighted mean pay settlement had been 3.3% in April, a rise of 0.1 percentage points from March. Data received so far for April had been predominantly in the public sector, where the twelve-month AEI-weighted mean pay settlement had risen by 0.5 percentage points. Across the subset of firms recorded in the Bank database as making a settlement in April of this year and in April of last year, the average settlement (not weighted by the number of employees) had been broadly unchanged.

A36 The Bank's first estimate of annual unit labour cost growth in 2001 Q1, using LFS data, had been 3.5%. The increase from 2.7% in 2000 Q4 had reflected stronger growth in earnings and slightly weaker productivity growth. Manufacturing unit labour costs in March had increased by 0.7% compared with a year earlier.

V Prices

A37 The Bank's oil-inclusive commodity price index had risen by 2.6% in April. The monthly increase had mainly reflected rises in the price of fuels. The fuels component of the index had risen by 4.5% in April, partly accounted for by the increase of around 4.6% in the average sterling oil price between March and April. The sterling oil price had since risen by around 8% in May. The Bank's oil-exclusive commodity price index had risen by 1.8% in April.

A38 Manufacturing input prices had risen by 1.0% in April, taking the annual inflation rate to 6.7% from 3.0% in March. In May, the CIPS manufacturing survey input price index had fallen below the no-change level of 50 for the first time since July 1999. Output prices excluding excise duties had risen by 0.1% in April, taking the annual inflation rate to 1.0%, up from 0.8% in March. The input price index did not include the effects of the Climate Change Levy, which had been introduced in April. However, the ONS had estimated that the introduction of the Levy had raised input prices by 0.9% in April. The expected output price balance in the CBI manufacturing survey had been broadly unchanged at -12 in May.

A39 The GDP deflator at market prices had risen by 0.5% in 2001 Q1. The annual inflation rate had risen to 2.1% in 2001 Q1, up from 1.2% in 2000 Q4. This had partly reflected a large rise in the annual inflation rate of the household consumption deflator, which had risen to 1.4% in 2001 Q1 from 0.7% in 2000 Q4.

A40 RPIX inflation had risen by 0.1 percentage points to 2.0% in April. There had been a sharp divergence between goods and services price inflation. Annual goods price inflation had fallen to -0.1% in April from 0.5% in the previous month. This large fall had mainly reflected a lower contribution from duties, as the effects of duty changes announced in the 2000 Budget were no longer in the annual comparison. Annual services price inflation had risen sharply to 3.8% in April from 2.8% in March. This significant increase had mainly reflected a large rise in the contribution from utility prices, as the reductions in water, gas and electricity prices in April 2000 no longer affected the annual rate. Annual RPI inflation had fallen to 1.8% in April from 2.3% in March. This had mainly reflected the fact that the effects of the abolition of Mortgage Interest Relief at Source (MIRAS) in April 2000 were no longer in the annual comparison. Annual RPIY inflation had risen to 2.2% in April from 1.8% in March, largely reflecting the higher contribution from utility prices. It had risen above annual RPIX inflation for the first time since March 2000. Annual HICP inflation had risen by 0.1 percentage points to 1.1%, the highest rate since December 1999.

VI Reports by the Bank's Agents

A41 The Agents reported that manufacturing output growth had slowed further, with falls in output in the information and communications technology (ICT) sector. Export growth had slowed, mainly as a result of lower orders from the United States, though there had also been some signs of weaker demand from Germany and parts of Asia. Overall, business confidence in the manufacturing sector had deteriorated.

A42 Construction output growth had continued to rise, following earlier weather-related disruption. Public sector construction had been increasing steadily in many regions. Demand for commercial construction had remained buoyant, particularly in the retail sector, and the Agents reported that demand for residential construction had also strengthened.

A43 The rate of growth in business services output had continued to ease, mostly due to the further slowing in financial services and ICT activity. There had been some evidence of stabilisation in growth of consumer services activity. Demand for tourism-related services had remained lower than a year ago, though contacts had reported some recovery since Easter.

A44 Investment intentions had weakened overall, according to the Agents. This had been particularly so in the ICT sector and for US-owned companies, with frequent reports of delayed expansion plans. Service sector investment spending had remained more robust than in manufacturing, particularly in the retail sector, though investment plans had softened somewhat, mostly due to the US slowdown.

A45 The Agents reported that moderate growth in retail sales volumes had continued in most regions and that consumer confidence had remained strong. Spending on new and used cars had continued to rise.

A46 There had been further evidence of slower service sector employment growth and declines in manufacturing employment. Skill shortages, though still a significant concern, had eased recently. Contacts had continued to suggest that the overall impact of changes to the National Minimum Wage would be small.

A47 The Agents had conducted a survey of UK firms regarding stocks. Overall, a net balance of firms had reported that their stock levels had been higher than expected in 2000 Q4 and 2001 Q1. This had been evident across all sectors of the economy with the exception of construction, where stock levels had been reported as lower than expected. On average, firms in most sectors had thought that their current stock levels were a little too high and planned to reduce them slightly over the following six months. The exceptions were construction and motor traders. Construction firms had

thought that their current levels of stock were too low and planned a slight increase; motor traders thought that their current stock levels were about right and on average had not expected to change them over the following six months.

VII Market intelligence

A48 Expectations of official interest rates implied by short sterling futures had risen since the Committee's May meeting, increasing by between 12 and 34 basis points for contracts maturing between 2001 and 2003. This rise had reflected some stronger-than-expected domestic indicators, including retail sales, RPIX and labour market data, together with some stronger-than-expected retail sales and confidence survey data for the United States. On 5 June, forward interest rates derived from various sterling money market instruments had implied an expected floor in the Bank's repo rate of 5% in 2001 Q3. However, most traders had expected that the Committee would leave the official repo rate unchanged at its June meeting. Similarly, economists polled by Reuters on 30 and 31 May had in aggregate attached a 71% probability of no change in the Bank's repo rate on 6 June.

A49 The rise in the sterling ERI since the Committee's May meeting had been primarily due to the weakness of the euro. The euro had reached new lows against the dollar and sterling for the year. Risk reversals had suggested slight net downside risk for the euro against the dollar. Forecasts for the level of the euro against the dollar over the following few months had been revised down by some market participants, and there had been a lower general expectation that the euro would regain parity with the dollar within the following twelve months. There had been some expectation that sterling might move less with the dollar against the euro than hitherto.