

Publication date: 21 March 2001

MINUTES OF MONETARY POLICY COMMITTEE MEETING 7 and 8 March 2001

These are the minutes of the Monetary Policy Committee meeting held on 7 and 8 March 2001

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0103.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 April will be published on 18 April 2001.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 7-8 MARCH 2001

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

The Budget

2 The Committee had been briefed by Treasury officials prior to its meeting on the broad outline of the Chancellor's Budget, including the current fiscal position, the Treasury's economic forecast and the projected implications for government receipts and spending which showed that the expected path for public sector net borrowing was close to previous projections. By the time the Committee made its decision, all the details of the Budget had been announced. The main fiscal impact was from the over-indexation of the starting rate band for income tax, the measures supporting families with children and the additions to departmental spending. Alcohol duties had been frozen. Relative to the Pre-Budget Report (PBR) forecast, extra revenue was now expected in the current fiscal year and the Treasury expected this structural improvement to persist into future years, broadly offsetting the cost of new measures. So the fiscal stance in the current year had once again turned out to have been tighter than projected, but the outlook had not been materially changed in the light of this improvement. To that extent, the Budget differed little from what had already been built into the Committee's projections included in the February *Inflation Report*.

3 In discussion at the Committee's meeting, it was suggested that the impact of the Budget measures on the composition of demand might nevertheless have some aggregate economic effects. The newly-announced measures would tend to redistribute income from higher to lower income families, which might have a higher propensity to consume out of their income. The more substantial PBR consultation measures, however, were largely petrol-related and so could tend to redistribute income in the opposite direction. At the same time, the supply-side measures might help to reduce the natural rate of unemployment. So both demand and supply could increase as a result of the Budget, but the net effect was likely to be very modest.

4 Some on the Committee questioned whether the convention of adopting the Treasury's nominal projections for government receipts and spending in the *Inflation Report* projections was appropriate, given that they were based on deliberately cautious assumptions. In particular, the strength of receipts, notably income tax, might be related to the current buoyancy of the economy and so could balance out over a full business cycle, but this should be reviewed in the context of the projections to be made for the May *Inflation Report*. There were also uncertainties as to the prospective rate of growth of real government spending. These included uncertainties relating to its composition and, for the given nominal profile, to the assumptions made about price deflators in the Committee's projections. These questions too would need to be reviewed in the context of the projections for the next *Inflation Report*.

Demand and Output

5 Turning to the latest GDP data, output growth in the fourth quarter was unrevised at 0.3%. Revisions to earlier quarters had changed the composition of expenditure somewhat. Consumption growth had been revised down by 0.1 percentage points for each of the first three quarters of last year and was 0.7% in the fourth quarter. After these data revisions, consumption was weaker than expected at the time of the February *Inflation Report*. On the other hand, the average rate of growth of business investment during the year had been revised up substantially and had been 3.2% in the fourth quarter. Its level was 3½% higher in the fourth quarter than had been projected in the February *Inflation Report*.

6 The pace of consumption growth appeared to have been maintained into the current year, with consumer confidence relatively firm and the housing market regaining some momentum after its recent pause. Retail sales growth had rebounded to 0.7% in January. It was likely that GDP growth would rebound somewhat in the first quarter, after a weak fourth quarter last year.

7 Though most members regarded these data as indicating a somewhat more robust picture of domestic demand growth than had been expected, some felt that the downward revisions to consumption should be given more weight than the revisions to investment: all the quarterly revisions to consumption growth last year were downwards, and the fourth quarter outturn had been lower than expected. By contrast, the direction of the revisions to data on investment growth varied

from quarter to quarter. Given the volatility of quarterly investment data, it was too soon to draw firm conclusions from the apparent recovery of investment growth in the fourth quarter. These members also noted that GDP growth in the fourth quarter remained a little lower than had been assumed as the starting point for the Committee's February projections, although the latest data on construction output suggested that GDP growth in the fourth quarter might be revised up slightly.

8 The Committee also had available to it at its meeting the latest Index of Production data, which indicated a fall of 0.9% in manufacturing output in January. This was matched by equivalent increases in other components which left the index overall unchanged on the month. A sharp fall in the output of the electrical and optical equipment sector, which had been growing strongly in recent months, more than accounted for the fall in manufacturing output. These movements could be erratic, although it was possible that they might reflect a more sustained weakening of the global technology sector.

Monetary and financial conditions

9 The latest monetary data showed robust growth in the main aggregates. Notes and coin, after allowing for estimates of millennium distortions, had grown by about 8½% in February, the fastest rate of expansion since September 1988. Though low inflation was likely to be part of the explanation for the faster growth of this aggregate, it was difficult to believe that this was the whole story and the figures were consistent with the buoyant data on retail sales. Broad money growth had increased to about 9½% in January, reversing signs the previous month of easing in the rate of growth. Total credit had grown rapidly, by 12.7% in the year to January.

10 There were differing interpretations of these data. Some members expected the projected slowdown in consumption growth to be associated with much weaker growth in credit aggregates, as households sought to reduce their indebtedness. There was still no sign that this rebalancing was yet in train, so the rapid growth of money and credit implied upside risks to the outlook for inflation. Others observed that holdings of notes and coin continued to rise relative to retail sales; and that, with nominal returns on savings so low and with the improved liquidity of savings instruments offered outside the M4 sector, substantial household asset reallocations and large swings in M4

aggregates could be expected without any material implications for the inflation outlook.

11 Mortgage loan rates had been falling faster than the Bank's repo rate, most recently as a result of more intense competition between mortgage lenders. If savers were similarly facing lower rates, the average interest rate faced by households would already have fallen relative to the Bank's repo rate. This might simply represent anticipation of a further cut in the official rate. But if the spread between mortgage and saving rates had narrowed, this would - other things being equal - be reflected in lower profitability and the value of bank shares would fall, with implications for household wealth. So some members were unsure about the extent to which this represented an overall easing of monetary conditions for households, with consequent effects on aggregate demand.

12 Short-term market interest rates had eased further over the month, in expectation of further cuts in the repo rate, and the market repo rate was some 20 basis points further below the Bank's repo rate than normal. The market expectation signalled by these rates was for cuts of 50 basis points over the next few months.

13 A number of medium-rated corporate bond spreads had widened since the start of the year. This was in large part a reflection of the sharp rise in spreads on telecoms sector bonds. Some members noted that this could have significant implications for corporate investment. Higher-rated corporate credit spreads on the other hand had narrowed slightly on the month.

14 Equity prices, both in the United Kingdom and internationally, had fallen sharply in February, reversing the rises in January. Some members thought that the widespread pattern of equity price falls indicated investor concern that weakness in the US economy would have a significant effect on other countries' growth prospects. By contrast, house prices seemed to be increasing again after a pause last year. The most recent price balance reported by the Royal Institution of Chartered Surveyors was back up to the level seen in the second quarter of last year. The latest equity price falls could be offset in their effects on households' total wealth by the implied housing wealth gains, and some members felt it was unlikely that they would yet be sufficient to have made households more concerned about the balance between their debt and wealth. This could, by allowing households' current very low savings rate to persist, weaken their financial positions and so increase the risk of a sharp adjustment if consumer confidence were to fall. But the nominal costs of

servicing debt were now relatively low and it was suggested by some that a given level of indebtedness might therefore be less worrying than in the past. On this argument, debt at current levels would be unlikely to constrain consumption or to prompt households to save more, unless employment prospects were to worsen.

The world economy

15 Outside forecasts for world growth were still being lowered, especially for Japan and the United States. Economic data for the United States were mixed: the fourth quarter outturn was not as bad as had been feared, and early indications for the first quarter were similarly somewhat stronger with retail sales up 0.7% in January. The purchasing managers' index had recovered slightly but remained very weak. Consumer confidence indicators had fallen sharply, with the expectations component of the Conference Board measure having fallen to its lowest level since October 1993, though the current conditions index had fallen much less. Nor was the inflation outlook wholly comforting, with CPI inflation at over 3½% and the core rate at best stable. If worries about inflation prospects were to develop, the authorities could become more cautious about providing a further stimulus to the economy. But some pointed to the fact that inflation outturns were a lagging indicator and that various leading indicators of inflation (for example, capacity utilisation and commodity prices) suggested falling inflation in future.

16 For some, the latest information made it seem more plausible that the slowdown in the United States would be prolonged rather than short-lived. Though backward-looking and current indicators of economic conditions had perhaps been stronger than expected, those with a more forward-looking content continued to weaken. Recent equity market falls had been driven by profit warnings, which were now no longer associated with predictions of early recovery. The general picture was of expectations for the first quarter being upgraded somewhat, but with those for the second quarter being revised down. The outlook for investment was weaker, and industrial sector capacity utilisation was at its lowest since August 1992.

17 Others noted that, while the trough might now be reached rather later than had previously been expected, that need not of itself imply that the slowdown would be any more protracted. It was important to differentiate between what was actually known (which was stronger than expected) and

what remained speculative. Though equity market prices had fallen back in February, they had so far done no more than return to their levels at the turn of the year.

18 Growth in Japan had been flat through last year and the Consensus forecast for the first quarter had been lowered. Growth in the euro area overall appeared to be stable, though somewhat lower than last year. There was recent evidence of weakness in Germany, with revised data suggesting slowing in the second half of last year and private domestic demand sharply lower, but the French economy was more robust. It was encouraging that there had been few signs of contagion from the severe economic problems faced by Turkey and Argentina.

19 In terms of the effects of these world developments on the United Kingdom, the evidence so far was consistent with the projection in the February *Inflation Report*. Business and consumer confidence remained strong, and exports to the United States in January had reversed the sharp fall recorded in the previous month's data. The Bank's regional Agents had reported some falls in orders from the United States, but these were balanced by gains elsewhere. They had also reported that some investment projects were being deferred. Admittedly, none of the forward-looking UK surveys asked questions directly related to the United States, although overall export optimism had fallen in a number of surveys, and so it was perhaps too soon to expect to see evidence of the effects of a US-related slowdown here. Moreover, recent falls in mortgage interest rates could be supporting consumer confidence while the decline in sterling against the euro from its peaks of last year might be supporting business confidence - so masking any effect from the US slowdown. But it nonetheless remained true that the evidence of a significant impact on the United Kingdom was so far slight.

The labour market

20 Labour market data remained hard to interpret. The sharp fall in employment as measured by the Labour Force Survey (LFS) was less pronounced in the latest release, covering the fourth quarter, than it had been in the three months to November. Permanent employment continued to grow and the recent offsetting falls in temporary employment could be erratic. These LFS data were not matched by similar falls in survey-based measures of employment such as those compiled for the Chartered Institute of Purchasing and Supply, which continued to show overall employment

growth. But the LFS data remained stronger than the available quarterly figures on Workforce Jobs. Data on unemployment showed a more consistent picture, with both LFS and claimant count measures falling. The most striking data were those for inactivity, which had risen sharply in recent months. This increase was concentrated among those who said that they did not want a job. The Bank's regional Agents reported some early indications of the labour market becoming less tight, but the data on quantities showed little sign yet of any significant loosening.

21 The latest data on the Average Earnings Index confirmed the upward trend in earnings growth which had developed during the second half of last year, and were somewhat stronger than expected. Earnings growth in private services had been above 5% throughout the fourth quarter and regular pay growth in the private sector had been rising steadily, from 4.3% in July to 4.9% in December. Information so far available on pay settlements in January was, however, less worrying and in line with expectations given the higher level of RPI inflation that month than a year earlier. The slowing pace of RPI inflation over the coming months should be a helpful moderating influence on settlements in April, the busiest settlement month of the year.

22 The Government had announced that the adult rate for the National Minimum Wage was to be increased to £4.10 in October. Initial staff estimates suggested that this could add 0.15 percentage points to the level of earnings and about 0.1 percentage points to price inflation. If differentials restoration were to be more extensive than assumed, it could increase these effects. But when the Minimum Wage was introduced in October 1998, the number of workers directly affected had turned out smaller than expected. Some sectors of the economy faced intense competitive pressure, which could further reduce pass-through from wages to prices. And some firms might already have adjusted wages in anticipation of an increase. Taking all these factors together, it did not seem likely that the effects on inflation from uprating to this level would be large, although this too would need to be reviewed in the context of the *May Inflation Report*.

Prices and costs

23 The Bank's regional Agents had carried out a special survey during February of firms' expectations of their ability to increase prices this year. This followed survey evidence a month ago that there had been an increase in such expectations - pointing to greater inflationary pressure in the

year ahead. Price expectations in these other surveys had this month fallen back, and the Agents' conclusion from their own survey was that firms' expectations were consistent with gently increasing inflationary pressures. This was in line with the central projection for RPIX inflation in the February *Inflation Report*. Comparing some of those survey responses this year with expectations a year earlier, however, the proportion of firms expecting to increase prices had fallen.

24 The tax changes in the Budget would lower RPIX inflation in March by about 0.1 percentage points relative to the Committee's February projection and the change in the timing of the Budget (which was a little earlier this year than last) would reduce RPIX inflation by 0.3 percentage points in April. Against this, utilities prices were likely to contribute an additional 0.3 percentage points to inflation in the second quarter, as the effects of last year's price cuts dropped out of the annual comparison. Initial estimates of the impact on food prices of the foot and mouth outbreak suggested that it could add 0.1 percentage points to the index, but these estimates were highly uncertain in timing and extent, and a wide range of outcomes was possible. So while these various effects together suggested very little net effect on inflation, timing differences could lead to erratic movements in the index over the coming months which would, the Committee agreed, have no direct significance for policy.

The immediate policy decision

25 The news on the month was mixed. The largest uncertainty for the outlook remained that surrounding world activity, and especially the outlook for the pace of growth in the United States. While the weakness evident in recent data was not perhaps as severe as had been feared, forward-looking indicators were less reassuring. But the prospects for domestic demand were if anything a little stronger than had been expected at the time of the February *Inflation Report*. The changes announced in the Budget were in line with what was expected from the PBR and so had little bearing on the Committee's decision this month.

26 For most members, the data did not support a further cut in the repo rate this month. The world economy was turning out broadly in line with the projections made at the time of the February *Inflation Report*. The most likely prospect for output in the United States was perhaps a little weaker than a month ago. While some comfort had been taken at last month's meeting from the

recovery in US equity prices in January, they had fallen back in February - though only to the levels seen at the start of the year. Confidence there remained very weak and while the slowdown to date had not been as abrupt as some commentators had feared, the trough might be reached rather later and the recovery might now be rather less rapid. The US slowdown could impact on the confidence of businesses and consumers in the United Kingdom, but it had not so far done so. The Japanese economy was faltering again, and its problems might be more deep-rooted than had previously been acknowledged: the difficulties were compounded by the fragility of its banking and insurance sectors. Prospects for growth in the euro area remained reasonably strong overall, though growth was a little slower than last year, and - so far - appeared little affected by the uncertainties emanating from the United States. UK exporters appeared to see improved demand from some regions which broadly offset weakness in US demand.

27 The domestic prospect seemed by contrast to be slightly stronger than a month ago. Consumption was still growing strongly. Money and credit data were consistent with it continuing to do so. The downward revisions to consumption growth through last year were small and might suggest a somewhat lower modal projection, but at the same time these revisions reduced the downside risk associated with the possible need for households to rebuild their balance sheets. The housing market seemed to be regaining momentum. Investment growth through much of last year had been revised up and now seemed to be more consistent both with survey evidence and with a stronger profile over the forecast horizon. The labour market showed little sign of easing and there were modest signs of strengthening earnings growth. Inflation remained below target, but not substantially so. The most striking feature of the UK economy was the strength of demand and confidence, despite the world outlook.

28 Some of these members noted the difficulties created by the current conjunction of relatively strong domestic demand and RPIX inflation edging further below target. There was little evidence yet that households were beginning to moderate their consumption in order to rebuild their balance sheets, and there were signs that the housing market was picking up again. A cut in rates now, though in other circumstances desirable in order to move RPIX inflation back to target, might instead lead to a further stimulus to consumer spending in the short term and a further worsening of household balance sheet positions, thus increasing the scale of adjustment which would be required if sentiment were to change. Were these domestic upside risks to diminish, or the downside risks

inherent in the world economic outlook to crystallise, it could become easier to take steps in the short run to move inflation back to target without adding to the risks in the medium term. For these members, such considerations were an important factor in their assessment of the appropriate timing of a change in the repo rate; and it was generally recognised that it would be necessary to respond to that eventuality if and when it arose.

29 Some other members, while accepting that the news was mixed, concluded that a further cut in rates was justified this month. The outlook for the world economy had deteriorated, which reinforced their assessment that world activity would grow less rapidly than the best collective judgment reflected in the Committee's February projection. Equities prices in the major markets had fallen and the number of profit warnings had increased and spread to more sectors. The slowdown was likely to be more prolonged, and possibly deeper. Domestically, there was news in both directions. The faster growth of average earnings was worrying, and would be highly relevant if it were to persist. The pick-up in the housing market was also a potential concern. But the latest data on manufacturing pointed in the other direction and could be the first sign that the global slowdown in the information and communications technology sector was also affecting the United Kingdom.

30 More fundamental on this view was that RPIX inflation had now been below target for 22 months, that it was continuing to slow and that it was not clear that the projected pace of output growth would bring it back to target over the forecast horizon. In particular, these members thought it implausible that inflation would return to target at the two-year horizon, as projected in the February *Inflation Report*, because they did not share the implicit assumption that output was currently above its full capacity level. The fiscal stance was slightly contractionary and monetary policy - with ex post real interest rates at around 4% on the basis of current inflation rates - was contractionary too. A dynamic monetary conditions index showed that, on this measure and at current interest and exchange rates, conditions would continue to tighten a little for the rest of this year and then stabilise. In any case, these members had thought that a 50 basis point cut could have been justified in February, because they believed that the level of rates needed to be realigned. So the justification for a cut this month was not merely the most recent news. There was no great urgency for such a cut, but the risks to inflation lay on the downside and it was preferable to take steps to bring inflation back to the target level sooner rather than later. Further cuts might be needed

if the downside risks from the world economy materialised.

31 The Governor invited members to vote on the proposition that the Bank's repo rate should be maintained at 5.75%. Seven members of the Committee (the Governor, Mervyn King, David Clementi, Christopher Allsopp, Charles Bean, Stephen Nickell and Ian Plenderleith) voted for the proposition. DeAnne Julius and Sushil Wadhvani voted against, preferring a reduction in the repo rate of 25 basis points.

32 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

Gus O'Donnell 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 2 March 2001, in advance of its meeting on 7-8 March 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 US industrial production in January had decreased by 0.3% from the previous month, the fourth consecutive month of decline. Some of the fall in January could be attributed to milder weather, which had led to a fall in utilities output of 6.0% on a month before, following a rise of 7.1% in December. Manufacturing output had fallen by 0.1% in January as a result of a 6.6% fall in motor vehicle production. Inventory growth outside the information technology (IT) sector had fallen in response to production cutbacks. In the IT sector, however, inventory growth had increased slightly. New capital goods orders (excluding erratic components) had increased by 6.5% in January, although the trend remained one of slowing growth. The NAPM purchasing managers' index had recovered slightly in February. Real consumer spending had grown by 0.2% in January from the previous month, and nominal retail sales by 0.7%. Sales of motor vehicles had picked up strongly, following weak sales in December. Both the Michigan and the Conference Board measures of consumer confidence had continued to decline in February; the Conference Board measure had reached its lowest level since June 1996.

A3 World equity prices had fallen during February, reversing the rises seen in January. In the United States, the Wilshire index had fallen by 9.6% and the NASDAQ index had fallen by 22.4%. Analysts' expectations of earnings per share in the United States for 2001 had fallen in February. Spreads on short-term commercial paper had narrowed slightly in February, while corporate bond spreads over 10-year swap rates had been little changed. The Senior Loan Officer Survey had shown that banks had tightened credit conditions between November and January, and demand for loans had fallen. Aggregate lending data, however, had shown that commercial and industrial borrowing had increased by 1.4% in January.

A4 In the euro area, GDP in 2000 Q4 had grown by 0.2% in Germany, 0.9% in France and 0.8% in Italy on the previous quarter. In Germany, domestic demand had been weak, and net trade had made a negative contribution to GDP growth in the fourth quarter. GDP growth there in the third quarter had been revised down by 0.3 percentage points, mainly due to a smaller positive contribution from domestic demand. In France and Italy, preliminary data had suggested that domestic demand growth, particularly investment, had contributed strongly to output growth at the end of 2000. The German IFO index had risen for the first time in eight months in January, though the forward-looking sub-component of the index had continued to decline. German manufacturing orders had fallen in January by 3.9% on the month. Industrial confidence indicators in France and Italy had continued to fall in February, but remained at high levels. Industrial and consumer confidence had also fallen slightly in the euro area as a whole. Retail sales in the euro area in December had risen on the previous month by 0.1%.

A5 Japanese quarterly GDP growth in the third quarter of last year had been revised down from +0.2% to -0.6%, due to a downward revision in the estimate of non-residential investment growth from 7.8% to 1.5%. In the fourth quarter, both household expenditure and output had remained weak. Industrial production growth had fallen by 3.9% in January, while construction output and domestic high-tech machinery orders had also declined. Confidence of smaller businesses had been little changed in February, following a sharp decline in January. The trade balance for Japan had been negative in January for the first time since January 1997, due to a sharp fall in export volumes to all of Japan's major trading partners.

A6 The spot price for Brent crude oil had fallen to \$26.64, from \$29.99 at the time of the Committee's previous meeting, partly due to downward revisions in expectations of world demand. The price of other industrial commodities had also declined, and the price of foodstuffs had been little changed.

A7 In the United States, producer prices had risen by 4.8% in the year to January, mainly driven by large increases in the prices of residential gas, tobacco and autos. Annual consumer price inflation had risen to 3.7% in January, from 3.4% in December. Core consumer price inflation, which excluded energy and food prices, had remained broadly stable for the past eight months. In the euro area, the harmonised index of consumer prices had increased by 2.4% in the year to January, while producer prices had increased by 4.8% in the same period. In Japan, domestic wholesale prices had fallen by 0.3% in the year

to January. Consumer price inflation had risen by 0.1%, but core consumer prices had continued to decline.

A8 Financial markets had expected a further reduction of official interest rates in the United States. Expectations of the path of official interest rates in the euro area had firmed slightly. The Bank of Japan had reduced its official overnight call interest rate from 0.25% to 0.15% on 28 February.

A9 Industrial production growth had risen slightly in Latin America and the Eastern European transition economies, but industrial production growth in Asia had continued to slow. Emerging market bond spreads had widened slightly. In Turkey, the spread on dollar-denominated sovereign debt had widened by about 90 basis points since 16 February.

II Monetary and financial conditions

A10 The twelve-month growth rate of notes and coin had recovered to 8.3% in February, as most of the distortion from the millennium echo had faded. The trend decline in the ratio of retail sales to notes and coin had been relatively stable over recent years, so the fall in the underlying growth of notes and coin suggested a possible easing in retail sales growth in February.

A11 M4 had risen strongly, by £10.2 billion (1.2%) in January, which had raised the twelve-month growth rate to 9.4%. The twelve-month growth rate of M4 excluding other financial corporations had picked up to 7.5%, its highest since December 1997. The twelve-month growth rate of aggregate M4 lending (excluding the effects of securitisations) had risen slightly to 12.7%.

A12 Household M4 growth had been strong in January, despite higher self-assessment tax payments: the twelve-month growth rate had been 6.9%. Analysis had suggested that the data were consistent with an upward shock to consumption in 2000 which had caused households to run down money balances. So some recovery in household M4 had not been unexpected.

A13 The twelve-month growth rate of net secured lending to individuals had been stable at 8.3% in January, while that of unsecured lending had slowed to 12.0%. The Bank's preliminary estimate of mortgage equity withdrawal in 2000 Q4 was £2.4 billion, little changed from 2000 Q3. The number of loan approvals had risen by 11,000 to 112,000 in January, and the number of outstanding mortgage approvals had continued to rise.

A14 The one-month flow of private non-financial corporations' (PNFCs') M4 had been moderate in January, although the twelve-month growth rate had risen to 10.2%. The twelve-month growth rate of PNFCs' borrowing had risen to 14.3%. The monthly flow of total external finance-raising had returned to the average of its level during 2000. The twelve-month growth rates of OFCs' M4 and M4 lending (excluding securitisations) in January had been 15.9% and 19.3% respectively.

A15 Short-term interest rate expectations, as measured by the two-week gilt repo curve, had fallen since the Committee's last meeting. Implied volatilities on short sterling contracts suggested that uncertainty about the immediate future had increased slightly. Nominal gilt yields beyond the three-year horizon had risen slightly. Corporate bond spreads had risen slightly, but spreads on telecoms sector bonds had risen sharply, continuing the trend of the last year. Issuance of sterling non-gilt bonds had been fairly strong. Survey-based measures of short-term inflation expectations had fallen, but longer-term inflation expectations inferred from gilt yields had increased.

A16 Retail rates had shown little change since the Committee's previous meeting: following the reduction in the Bank's repo rate, the Standard Variable Mortgage Rate (SVR) had fallen by only one basis point in February. Reductions that had been announced to take place in March were likely to reduce the SVR by more than 25 basis points. There had been reductions in fixed and discounted mortgage rates. Remortgaging as a percentage of gross lending had risen in January.

A17 The FTSE All-Share index had declined by 3.4% since the Committee's previous meeting, while the Small Cap index had declined by 3.9%. IT, non-cyclical services and financials had been the weakest sectors. The number of profit warnings made by UK firms in February had been higher than in the same month in 2000, and had been distributed more widely across sectors than in January.

A18 Since the Committee's previous meeting, the sterling exchange rate index had risen by 0.7% to 104.5 and the main sterling bilateral exchange rates had been little changed.

III Demand and output

A19 Quarterly GDP growth at constant market prices had been unrevised at 0.3% in 2000 Q4, though the annual growth rate had been revised up to 2.5% from 2.4%. Quarterly growth in 2000 Q3 had been revised up to 0.8% from 0.7%. Total industrial production had fallen by 0.6% in 2000 Q4. Manufacturing output had grown by 0.5% in 2000 Q4, while service sector output had grown by 0.7%, unrevised from the preliminary estimate. Agricultural output had fallen by 3.0% in Q4 and construction output had fallen by 0.1%. DETR data published after the GDP release had shown that construction output grew by 1.5% in Q4. More recently available data had shown that manufacturing output had fallen sharply by, 0.9%, in January. That had reflected a very steep decline in optical networking and mobile phones output after a sharp build-up in December. Utilities output had risen in January following a fall the previous month. Overall industrial output had therefore been unchanged in January, but had fallen by 0.6% in the latest three months on the previous three.

A20 The expenditure breakdown of GDP showed that final domestic demand had grown by 0.7% in Q4. Domestic demand had grown by only 0.1%, however, as the change in inventories had reduced quarterly growth by 0.6 percentage points.

A21 Private sector consumption (including that of non-profit institutions serving households) had grown by 0.7% in 2000 Q4. There had been downward revisions to consumption growth in 2000, primarily related to the consumption of services. The level of consumption in 2000 Q3 had been 0.3% lower than previously thought. Real government consumption had risen by 0.2% in Q4, down from growth of 1.2% in Q3. Total investment (including acquisitions less disposals of valuables) had grown by 1.2% in 2000 Q4. There had been significant upward revisions to investment in 2000: the revised level of total investment in 2000 Q3 had been 1.5% higher than previously thought. Business investment had risen by 3.2% in Q4, and was 4.0% higher than a year earlier. Within this, manufacturing investment had fallen by 5.2% in 2000 Q4, while service sector investment had risen by 4.5%.

A22 Inventories had made a negative contribution to GDP growth in 2000 Q4. Inventories (including the alignment adjustment) had been estimated to have fallen by £0.2 billion in Q4, compared with a rise of £1.1 billion in Q3. Excluding the alignment adjustment, inventories had risen by £0.5 billion in Q4.

A23 Net trade had contributed 0.2 percentage points to GDP growth in 2000 Q4, following a contribution of -0.2 percentage points in Q3. Total exports of goods and services had risen by 1.4%, while imports had grown by 0.7%.

A24 Turning to indicators of activity in the first quarter of 2001, retail sales volumes had risen by 0.7% in January, broadly in line with the January CBI Distributive Trades survey, which had shown a total balance of +36 retailing respondents reporting higher sales in January compared with a year ago. This balance had fallen slightly to +32 in February. The MORI measure of consumer confidence had risen slightly in February, while the GfK confidence index had fallen slightly. Households' confidence about their own situations remained firm on both measures. Private new car registrations in February had been 15.4% higher than a year earlier. On the same basis, total new registrations had been 7.3% higher.

A25 Housing indicators had been mixed in February. The Halifax house price index had risen by 1.6%, but the Nationwide measure had fallen by 0.8%. Annual house price inflation had continued to be markedly different on these two measures, with the Halifax reporting annual increases of 3.4% compared with 8.1% on the Nationwide measure. Particulars delivered had fallen by 3,000 to 109,000 in January, but the number of loan approvals had increased to a record high of 112,000. Private housing starts and completions had both risen in January.

A26 The manufacturing output expectations balance in the CBI Monthly Industrial Trends survey had fallen to +9 in February. The total orders balance had fallen to -16 in February, and the export orders balance had fallen to -24. The headline index of the Chartered Institute of Purchasing and Supply (CIPS) services survey had remained unchanged at 57.1 in February, and the CIPS construction index had fallen slightly to 57.5. Construction new orders had fallen by 8.0% in the three months to January compared to the previous three months. The headline index of the CIPS manufacturing survey had risen very slightly to 52.1 in February. The output index had fallen to 53.3, while total new orders had picked up at the fastest

rate since December 1999, although export orders had risen less strongly.

IV The labour market

A27 According to the Labour Force Survey (LFS), employment had fallen by 5,000 in 2000 Q4. Changes in female employment had been a key feature of recent outturns, and had accounted for all the falls in both self-employment and part-time employment. Nevertheless, growth in permanent employee numbers had continued and the sharp downturn in temporary employees had not persisted.

A28 The part-time share of employment had fallen back from its 2000 Q3 peak. Average (and total) hours worked had grown by 0.4% in 2000 Q4. This had been more than accounted for by an increase of 2.2% in part-time hours and of 5.8% in second-job hours. The increase in part-time working in recent years had been concentrated in jobs of around 20 hours per week. This had reduced the share of short-hours jobs in the part-time total.

A29 The CIPS surveys in February had suggested that employment had continued to grow and had shown no evidence of the 2000 Q4 dip seen in the LFS data. According to the Recruitment and Employment Confederation, scarcity of agency staff had continued to become less widespread.

A30 LFS unemployment had decreased by 21,000 in 2000 Q4, reversing the increases seen in the previous two releases. Over the same period, the claimant count had fallen by 14,200 and by a further 25,500 in January, to its lowest level since December 1975. The increased rate of decline in the claimant count had been accounted for by higher outflows. Over-25s had accounted for the decline in the LFS unemployment rate, while the recent positive contribution from youth unemployment had moderated.

A31 The working-age inactivity rate had risen by 0.2 percentage points in 2000 Q4. This had been entirely due to a rise of 0.5 percentage points in the female inactivity rate. The rise in inactivity had continued to be accounted for by a rise in those who did not want a job. The Bank's measure of weighted non-employment had been flat in Q4: the increase in inactivity, even when weighted to reflect the lower

transition rate into employment, had offset the decline in unemployment. All durations of unemployment had contributed to lower weighted non-employment.

A32 Annual manufacturing productivity growth had increased by 1.0 percentage points in December. The Institute of Management Services (IMS) index had risen in January. The low outturn for GDP growth in 2000 Q4 had depressed the Bank's LFS-based first estimate of annual whole-economy productivity growth; and the gap between the heads and hours measures had narrowed as a result of an increase in average hours worked.

A33 Whole-economy headline earnings growth, as measured by the Average Earnings Index (AEI), had risen by 0.2 percentage points in December. Headline growth in the private and public sectors had risen by 0.1 percentage points and 0.4 percentage points, respectively. The sharpest increase in annual earnings growth had been in private sector services, where it had increased by 0.6 percentage points to 5.1%. Bonuses had made a positive contribution to earnings growth (not seasonally adjusted) for the first time since April 2000, with both the public sector and financial services sector bonus contributions substantially higher in December than in previous months. Regular pay growth (not seasonally adjusted) had continued to edge upwards in both manufacturing and the public sector. Growth in regular pay in private sector services had been more than 5% throughout the fourth quarter.

A34 There had been no evidence of any marked increase in settlement levels compared with the previous year. The Bank's twelve-month AEI-weighted means for the whole economy and the public sector had been unchanged in January. The private sector mean had risen by 0.1 percentage points. New data, on September deals, had resulted in upward revisions to the previous autumn's three-month mean. There had been an average increase of 0.33 percentage points in the 70 deals taking effect in January which could be matched with those firms' settlements in 2000. Excluding 15 multi-year deals, the matched increase had been 0.26 percentage points.

A35 Manufacturing unit wage costs had fallen again. Overall annual earnings growth had been higher and LFS-based productivity growth lower in Q4. Annual growth in unit wage costs had risen to 2.9%, on the Bank's first estimate.

V Prices

A36 The Bank's oil-inclusive commodity price index had fallen by 0.2% in January, but due to base effects the annual inflation rate had risen slightly to 6.7% in January from 6.5% in December. The monthly fall had mainly reflected falls in the prices of fuels. The fuels component of the index had fallen by 1.2% in January, which had been largely accounted for by the fall of around 1.3% in the monthly average sterling oil price. The oil price had strengthened by around 9% in February. The Bank's oil-exclusive commodity price index had risen by 0.3% in January, which had taken its annual inflation rate to 4.6% in January from 4.0% in December.

A37 Manufacturing input prices had risen by 0.5% in January, which had taken the annual inflation rate to 6.3% in January, from 5% in December. After rising sharply to 58.0 in January, the CIPS input price index had fallen back to 55.8 in February. Output prices excluding excise duties (PPIY) had fallen by 0.2% in January, and the annual inflation rate had eased to 1.2% in January from 1.5% in December. Looking forward, the CBI manufacturing survey expected output price balance had fallen back sharply, to -14 in February from +4 in January.

A38 The GDP deflator at market prices had risen by 0.3% in 2000 Q4. Its annual inflation rate in 2000 Q4 had fallen to 1.2%, after being revised up to 1.8% (from 1.6%) in 2000 Q3. The GDP deflator had been revised up in the first three quarters of 2000, leaving it 0.2% higher in 2000 Q3 than it had previously been. The annual inflation rate of the household consumption deflator had fallen slightly to 0.8% in 2000 Q4, after being revised up to 0.9% (from 0.6%) in 2000 Q3. Revisions had raised the level of the household consumption deflator in 2000 Q3 by 0.3%. The annual inflation rate of the government expenditure deflator in Q3 had risen to 3.1% in 2000 Q4 from an upwardly-revised 2.5% in 2000 Q3. The quarterly change in the import price deflator in 2000 Q3 had been revised up to 0.6% from 0.1%. The import price deflator had risen by 1.2% in 2000 Q4, the largest quarterly rise since 1995 Q3.

A39 RPIX inflation had fallen by 0.2 percentage points to 1.8% in January. Both goods and services price inflation had eased in January: annual goods price inflation had fallen to 0.3% from 0.5%, while annual services price inflation had fallen to 2.9% from 3.2%. RPI inflation had fallen to 2.7% from 2.9%.

RPIY inflation had also fallen, to 1.5% from 1.7%, while HICP inflation had been unchanged at 0.9%. Consequently, the gap between RPIX and HICP inflation had narrowed to 0.9 percentage points.

VI Reports by the Bank's Agents

A40 Manufacturing contacts had continued to report a further slight strengthening in overall demand from export markets. There had been more widespread evidence of a slowing in orders as a result of the downturn in the US economy (notably for automotive and high-technology goods), but any impact had remained relatively small. Moreover, most manufacturing contacts had suggested that any slowdown in demand from the United States had been offset by improved conditions in other markets. In contrast, growth in demand from domestic firms had slowed somewhat in some regions.

A41 Contacts had continued to suggest little recovery in construction output, following the weather-affected downturn reported in earlier months. However, on balance, most Agencies had continued to suggest that underlying confidence and expectations regarding future construction activity remained robust, although there had been some suggestions of a slightly softer outlook for residential activity in some regions.

A42 The Agents had stressed that the agricultural sector had not yet recovered from the earlier wet weather. In particular, contacts had suggested that the supply of domestically-produced potatoes and cereals would be adversely affected for some time. Moreover, the output of the sector was likely to be further depressed by the recent outbreak of foot and mouth disease.

A43 Although conditions in the labour market had remained tight, Agencies in London and the Midlands had noted early signs of an easing in shortages in some sectors (notably financial services).

A44 Materials costs inflation had continued to ease recently, though there had been more reports of concerns regarding administrative and regulatory costs. In most cases, manufacturing output prices were now broadly flat, although there had been more reports of price increases being achieved by some firms.

A45 The Agents had conducted a survey of around 170 UK firms regarding expectations of movements of their prices for 2001. The results had shown that a net balance of 14% of firms surveyed expected to increase their prices this year by more than last year (or reduce their prices by less than last year). While price rise expectations had been most common in non-retail services, the magnitude of increases had been expected to be broadly similar to last year. In contrast, while the survey had indicated that retail goods prices remained broadly flat overall, upward inflationary pressures were strongest in this sector. There had been a more mixed picture in manufacturing. Costs of labour, fuel and materials, and regulation had been the most frequently cited factors causing firms to expect to raise prices by more than last year. In contrast, those firms which had reported a slower pace of expected inflation this year had suggested that competitive pressures and productivity had been the main causes.

VII Market intelligence

A46 Expectations of short-term interest rates implied by short sterling futures contracts had risen slightly at very short maturities, and had fallen by up to 10 basis points for contracts maturing in late 2001 and 2002. The moderate rise in interest rate expectations had followed the release of average earnings data and the publication of the *Inflation Report* on 14 February, and publication of the CBI Distributive Trades survey in early March. The fall in interest rate expectations at longer maturities had mainly reflected falls in market interest rates abroad, in particular in the United States. The implied volatility of short sterling futures had remained low in comparison with levels in 1999 and 2000, and relative to comparable United States and euro-area interest rate contracts. A majority of market participants did not expect a reduction in the Bank's repo rate this month: in the most recent survey of private sector economists conducted by Reuters in early March, the mean probability attached to a cut in the Bank's repo rate in March had been around one third.

A47 The sterling effective exchange rate index (ERI) had appreciated slightly since the Committee's previous meeting. The stability of the ERI so far in 2001 was in contrast to its sharp fall in the fourth quarter of 2000. Over the same period, the euro had weakened slightly against the dollar. Some commentators had suggested that this was surprising, given generally stronger-than-expected euro-area data, greater falls in short-term market interest rates in the United States than in the euro area and the falls

in US equity market indices, which were consistent with concerns about US economic weakness.

However, although the Standard and Poor's 500 index had fallen in absolute terms, it was if anything higher relative to the Dow Jones Euro Stoxx 50 index. Another possible explanation of the euro's depreciation against the dollar had been that surveys of market positioning had suggested that some participants had sought to reduce the holdings of euros in their portfolios. There had been indications that pending capital outflows from the euro area to the United States, which were related to mergers and acquisitions, had slowed.