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# MINUTES OF MONETARY POLICY COMMITTEE MEETING 7 and 8 November 2001

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

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0111.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 December will be published on 19 December 2001.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 7-8 NOVEMBER 2001**

1 Before turning to its immediate policy decision and against the background of its latest projections for output and inflation, the Committee discussed the world economy; demand and output; money, credit and asset prices; the labour market; prices and costs; and some possible tactical considerations.

### **The world economy**

2 The Committee explored whether or not there might be different signals on the position of the global economy from the official data released over the month, surveys, and asset prices. Some contrasts were, at least at first sight, arguably present in the US data and surveys. On the one hand, output had fallen by only 0.1% in Q3 over Q2, rather less than generally expected. Recent data suggested that some elements of consumer spending had recovered somewhat following a dip immediately after 11 September; for example, spending on vehicles had been robust, although it was difficult to assess how much that was due to 0% finance deals and so how persistent it would be. On the other hand, surveys had been very weak. The National Association of Purchasing Managers' (NAPM) index for manufacturing had fallen from 47.0 in September to 39.8 in October, the largest monthly fall since 1984. The non-manufacturing NAPM had also fallen sharply – from 50.2 to 40.6 – over the same period. The US Conference Board measure of consumer confidence had dropped from 97.0 to 85.5, although the Michigan measure had risen slightly. The one area where the official data were conspicuously weak, and so apparently more consistent with the picture from surveys, was the labour market. Unemployment had risen from 4.9% to 5.4% in October, and payrolls had dropped by 415,000, with September's fall revised up to 213,000.

3 Albeit to a lesser degree than for the United States, the signals from data for the euro area were also mixed. On the one hand, there were perhaps some signs of stabilisation in recent industrial production and consumer spending data. On the other hand, business confidence had fallen from -12 in September to -16 in October. The manufacturing purchasing managers' index (PMI) was down to 42.9 from 45.9 in September, and the services PMI had dropped from 49.0 to 46.7. Consumer confidence had fallen too.

4 One possible explanation for these mixed signals was that the official data showed that the world economy had been slowing less rapidly in the period leading up to 11 September than the Committee

had thought at its previous meeting; in his recent Congressional testimony, Chairman Greenspan had appeared to take a view of the US economy consistent with that. If so, the forward-looking surveys and the US labour market data might reflect a bigger-than-previously-expected impact from the 11 September tragedy. In that case, the question was whether the effects would be persistent or transitory. The sharp changes in employment and unemployment were plausibly to some extent a one-off adjustment by firms in sectors that were particularly adversely affected (for example, airlines, hotels, and transport services) – though in some cases perhaps bringing forward adjustments to overcapacity existing before 11 September. However, over half of the fall in employment seemed to have occurred in sectors which were not so obviously directly affected. It was too early to reach robust judgments about the outlook for US labour market conditions.

5 It was difficult to know whether the surveys were conveying hard information about changes in spending plans or a more general deterioration in sentiment. Given the trauma experienced in the United States, there was likely to be some element of the latter, which would be difficult to map into forecasts of economic behaviour. But some survey measures, including the US NAPM, were built up from detailed questions about actual economic circumstances and plans, which fortified a judgment that the surveys were indeed pointing to a markedly weaker near-term economic outlook. It was suggested that this was corroborated by a range of other US indicators. For example, manufacturing capacity utilisation was lower than for nearly twenty years, house price growth had eased back for two months, the housebuilders index was down, and the Michigan survey recorded households as expecting the slowest rate of income growth for around ten years.

6 Asset prices, however, seemed to tell a different story. Although well down from the levels prevailing when the Committee agreed its August projections, world equity prices had recovered from the post-11 September fall, rising materially over the month: the Wilshire by 4.9%, the Dow by 4.7%, the Dax by 9.6% and the FTSE All Share by 7.2%. In part, that might be explained by the ebb and flow of uncertainty being reflected in fluctuations in risk premia in financial markets. It was also possible that asset markets were reflecting the effects of reductions in official interest rates on the rate at which expected corporate earnings were discounted, together with a market view that earnings growth would be weak only temporarily given that monetary policy easing and, in the United States, a prospective fiscal stimulus over and above the operation of the automatic stabilisers. Some support for that view was provided by the US \$ short-term interest rate futures contracts, which embodied a market expectation of rising rates next year and therefore implied an expectation of recovering growth

by then. While near-term forecasts of corporate earnings growth had been marked down, the expected longer-term growth rate had not changed much, though at 14% per annum the Institutional Brokers Estimate System survey of longer-term earnings growth still looked relatively high.

7 Against that background, and with Japan in recession and other parts of Asia notably weak given the sharp decline in demand for information and communications technology (ICT) goods, the Committee agreed that the slowdown in world economic growth was now likely to be both deeper and longer than earlier thought. Views varied on the degree of the deterioration. Some members noted that some recent outside forecasts of world growth were materially weaker than the Committee's.

### **Demand and output**

8 As in the rest of the world, there were some differences between backward and forward-looking indicators of activity in the United Kingdom.

9 The preliminary output-based estimate for GDP growth in Q3 had, at 0.6%, been a little higher than expected. The September industrial production data suggested, however, that it might be revised down slightly; and it was suggested that the pressures on some sectors, for example hotels, were perhaps not yet reflected in the data. Against that, there had been significant upward revisions to preliminary estimates over the past ten years.

10 The differences across sectors of the economy had been more apparent in the recent data. Manufacturing output had fallen by 0.8% in Q3, largely reflecting continued weakness in the electrical and optical sector, whereas services was estimated to have grown by 0.8%, with distribution particularly strong. Consistent with this picture of increased imbalances, consumption had so far remained robust: retail sales had grown by 0.2% in September and by 1.5% in Q3 as a whole. There were, though, some signs of a slowdown in forward-looking surveys and other indicators. Consumer confidence, on both the GfK and MORI measures, was weaker than a few months ago. The CBI Distributive Trades survey suggested that consumption had weakened in October. House prices (on both the Halifax and Nationwide measures) had fallen slightly on the month, and mortgage loan approvals had dipped. However, the October British Retail Consortium (BRC) survey of retail sales, by contrast, had been strong. Looking further ahead, the Committee concluded that the falls in financial wealth this year, softer labour market conditions and the drop in consumer confidence, taken

together, pointed to a prospective slowdown in household spending growth. But members varied in their confidence as to whether the slowdown had already begun and about how rapid it would be.

11 There were probably clearer signs of a slowdown on the output side. The Chartered Institute of Purchasing and Supply (CIPS) services activity balance had fallen from 48.1 in September to 46.3 in October – the lowest level since the series began in 1996, although as an indicator of future services activity it provided only part of the picture since it excluded the recently-strong distribution sector. Although it had edged up slightly on the month, the CIPS manufacturing PMI was still weak, pointing to falls in activity; and the monthly and quarterly CBI manufacturing surveys had weakened further. The construction PMI index had fallen below 50 in October, to its lowest level for around two and a half years. This suggested to some members that the weakness initially evident in industrial production might be spreading through the economy. The Bank's regional Agents had reported that business confidence was weak, with further declines in manufacturing orders and slowing activity in business services.

12 On balance, the Committee concluded that UK demand and output growth would, at an unchanged repo rate of 4.5%, be weaker over the next year or so than expected at its previous meeting.

13 Given that the prospective slowdown was rooted in the shocks to global activity and demand, the Committee debated the implications for UK net trade. It was striking that imports as well as exports had been weak so far this year. This was presumably at least partly accounted for by a slowdown in inventory accumulation: there had been a particularly large fall in UK imports of intermediate goods. That in turn reflected the nature of the shock which, in large measure, was to global demand for ICT capital goods. As investment goods had a high import content, that would tend to bring about falls in imports as well as in exports and domestic demand. Since imports would contract, aggregate demand and output growth would plausibly fall by less than would simply be implied by the reduction in exports. To that extent, the negative contribution of net trade to UK output growth would tend to be smaller than from a more generalised adverse shock to global demand.

14 Even after taking that into account, however, the Committee was projecting increasing trade and current account deficits, partly reflecting a view that domestic demand would continue to grow faster in the United Kingdom than in the rest of the world. That was part of the background to the downside risk to the exchange rate incorporated into the Committee's published fan charts.

## **Money, credit and asset prices**

15 The money and credit data provided one possible cross-check on the picture presented by the data and surveys on demand and output. The household monetary data remained very strong: household M4 and Divisia money were growing robustly, credit growth was now over 10%, and mortgage rates were at record lows. Taken together, these data pointed to continuing robust household spending in the near term. By contrast, the corporate sector monetary data were more consistent with weakness.

16 The Committee debated the risks to sterling's exchange rate. Some members placed considerable emphasis, given the projection of persistent trade deficits, on the potential upside risks to inflation from the possibility of a sterling depreciation. For them, it was not easy to see how the external/internal imbalance could be resolved at the current real exchange rate.

17 Some other members were doubtful whether downside risks to sterling implied upside risks for the inflation outlook, emphasising that the implications of any depreciation for inflation and so for policy would depend crucially on the circumstances in which it occurred. By way of illustration, various possible scenarios were identified. First, any tendency for sterling to depreciate might be moderated in an environment of a recovering world economy and robust domestic demand growth, since financial markets might then expect monetary policy to be tighter than otherwise. Second, if sterling were to fall against a background of persistently weak external demand, the implications for aggregate demand and inflation might be welcome. Third, if households were abruptly to cut spending in order to rebuild their balance sheets, a weakening exchange rate might help to alleviate the impact on aggregate demand and inflation. More broadly, there was uncertainty about the extent to which a sterling depreciation would feed through into domestic prices. Provided any fall in the exchange rate was moderate, foreign exporters might accept lower margins, leaving their sterling prices more or less unchanged, so that the direct effect on the price level might be quite small.

## **The labour market**

18 Employment had fallen slightly over the three months to August compared with the previous three months. It was no longer growing at the same rate as the population of working age. On the Labour Force Survey measure, unemployment had risen over that period, although it had continued to fall, including in September, on the claimant-count measure.

19 Surveys generally pointed to weaker employment intentions, and the CIPS services survey indicated falling demand for labour for the first time since early 1999. The Bank's regional Agents had reported that a turning point had been reached. The October Recruitment and Employment Confederation survey of agency workers, although not fully representative of the labour market as a whole, had recorded weaker demand for temporary staff as well as continuing weak demand for permanent placements. While the BCC survey continued to report recruitment difficulties, it was possible that this reflected problems for firms in finding the specific skills and experience mix they desired, and as such might have a structural as well as a cyclical element.

20 Regular pay had been increasing at an annual rate of over 5%. But headline earnings growth had been stable at around 4½% for four months, as bonuses had been falling quite sharply. Members felt that bonuses were likely to continue to fall in some sectors, such as financial services, in the period ahead. The Bank's regional Agents had suggested that the more difficult environment was lowering expected wage increases.

21 Overall, there were some signs, therefore, that labour market conditions had at least plateaued, and were perhaps easing slightly.

### **Prices and costs**

22 Oil prices were down about \$2 per barrel on the month, and other commodity prices had weakened too. Sterling commodity prices had fallen slightly in the twelve months to September, a sharp turnaround from increasing at an annual rate of over 10% in the summer. The CIPS survey input price series was also weak. These developments were not surprising given the slowdown in world activity. While it was not clear precisely what was implied for UK retail price inflation, given the less close link in recent years between input prices and retail prices, it was clear that 'pipeline inflationary pressures' were subdued globally and in the United Kingdom.

23 The short-term outlook for RPIX was somewhat weaker than a month ago, partly reflecting the likelihood that the fall in oil prices would pass through quickly into UK petrol prices.

## **The November GDP growth and inflation projections**

24 The Committee reached its policy decision in the light of the projections to be published in the *Inflation Report* on Wednesday 14 November.

25 On the assumption of an unchanged official repo rate of 4.5% over the next two years, the central projection would have been for RPIX inflation to be materially below the 2½% target throughout the forecast period.

26 On an alternative assumption of an official repo rate of 4.0% over the next two years, the central projection was for GDP growth to be below trend for a while next year before recovering to about trend around the end of the two-year forecast horizon. The central projection for RPIX inflation edged down to around 2% in the coming months before rising back towards the target. In the *Inflation Report* fan charts, the risks to growth were balanced, and the risks to inflation were weighted slightly to the upside, principally reflecting the possibility of a sterling depreciation.

27 Some members preferred different assumptions for both the central projections and risks. Some thought the most likely outlook for inflation was a little higher. Others thought that it could be up to half a percentage point lower, reflecting views that the world economic downturn was likely to be deeper and longer than assumed, that the effect of the global slowdown on UK inflation would be greater, and that there would be downward pressures on inflation from higher-than-earlier-thought supply capacity in the economy. On risks, some members placed greater weight on the possibility of a sterling depreciation and on the projected slowdown in consumer spending taking a while to come through. Others assigned a lower probability to a depreciation when the UK economy was growing faster than the rest of the G7, but placed more weight on the possibility that consumer and/or corporate spending would weaken soon and sharply or on the risk of the world economy being even weaker than in their central projection. For them the balance of risks for both growth and inflation was on the downside.

## **Possible tactical considerations**

28 The Committee noted that the balance of market opinion was that there would be an immediate repo rate cut of 25 basis points, with a strong expectation that rates would move lower in subsequent



months; but that some weight was placed on the possibility of a 50 basis point cut this month. A ‘no change’ decision would come as a considerable surprise.

29 The Federal Reserve had the previous day cut by a further 50 basis points, and the ECB was meeting at the same time as the MPC. Members noted that the reaction in financial markets, particularly in currency markets, to whatever they decided to do was difficult to predict, and would depend partly on what the ECB did.

30 If a cut larger than 25 basis points were judged to be warranted by the economic fundamentals, one possible tactical consideration was whether, in terms of the likely impact on confidence, there was greater advantage in moving in one step or in a series of smaller steps. Given the possible fragility of confidence in the current environment, the factors relevant to the decision depended to a greater extent than usual on judgments of timing and psychology.

### **The immediate policy decision**

31 For most members, the outlook for inflation, and the balance of risks, were broadly as published in the *Inflation Report* fan charts. Even before 11 September, the global economy had slowed more than had been built into the Committee’s August projections; and the tragic events of 11 September had been a further negative shock, probably with larger effects than the Committee had assumed at its October meeting. World price pressures were also now weaker. Domestically, output growth had so far been remarkably resilient, staying fairly close to trend. There were, though, now signs of a slowdown. These were most evident in the surveys and in reports from the Bank’s regional Agents. Consumption growth was expected to slow given the fall this year in financial wealth, weaker household confidence and the evidence of easing in labour market conditions, but a key question was when that slowdown would start to come through. Cost and price pressures were subdued. The latest projections reflected this analysis. For these members, therefore, the immediate policy choice, turning on judgments of the effects on confidence, was between an immediate reduction of 50 basis points and a reduction of 25 basis points immediately with a clear prospect, assuming no material news in the interim, of a further 25 basis point cut at a subsequent meeting.

32 Various possible arguments – given different weights by different members – were identified which might favour an immediate cut of only 25 basis points. First, the assessment of the deteriorating

outlook placed considerable weight on surveys. But surveys tended to be volatile and might be influenced by temporary factors. Given that the hard data on consumption and domestic demand remained strong, there was a case for waiting to see evidence of whether retail sales had, in fact, slowed since September, and whether the weakness in surveys persisted. Too large a cut might fuel consumer borrowing growth excessively, weakening household balance sheets and adding to risks for the future, so prudence might point to delaying until there was harder evidence of a slowdown. Second, a 50 basis point cut might incorrectly signal that conditions in the United Kingdom were as difficult as in the euro area, and as in the United States, where the FOMC had already cut by a further 50 basis points. If so, the effect might, perversely, be to dent rather than support confidence. Third, a sequence of small cuts might have a more potent effect on confidence than a larger cut if the fact of cutting, and the attendant media coverage, were important. Fourth, there might be a larger overall effect if a cut now were followed by another at the Committee's December meeting, which fell in the middle of the Christmas shopping period.

33 Most members nevertheless concluded in favour of an immediate reduction of 50 basis points. First, a 50 basis point cut might do more to underpin confidence domestically, by underlining the Committee's continued readiness to act to support demand in line with achieving the inflation target over the medium term. A departure from moving in relatively small steps might have an effect particularly well suited to the current conjuncture, when the considerable uncertainty about economic prospects might be affecting business and consumer confidence. Second, although there was no mechanical link between the Committee's projections and policy, it would not be easy to explain why rates had not been cut by 50 basis points, since the forecast would clearly imply that a 25 basis point cut was very likely to be followed shortly by another. The publication of the *Inflation Report* would provide an opportunity to explain why the Committee had opted to move by 50 basis points, and the various uncertainties and risks. Third, given the fragile conditions internationally, a 50 basis point cut might help, alongside policy easings elsewhere, to support confidence internationally. That was relevant to the United Kingdom since the prospect of domestic slowdown was largely a consequence of the international weakness. Fourth, although there was uncertainty about the signals from the surveys, it was very unlikely that they would bounce back in the way they had following their similarly sharp weakness in the autumn of 1998. The dip then had been prompted by global financial system distress, which had been successfully resolved, whereas now it was caused by shocks to the international real economy which were apparent in hard data. Given the prospect for inflation, there

was almost no risk that the Committee would want in the near term to reverse a 50 basis point reduction.

34 For one member, the immediate policy choice lay between a cut of 50 or 75 basis points. The news on the international front had been much worse than expected – in the United States, the euro area, and Japan. Reflecting that, the latest outside forecasts of world growth in 2002 were materially weaker than assumed in the Committee’s central projections. On this view, the impact of the international downturn on UK inflation would be greater than assumed, and that central projection also underestimated the supply potential of the UK economy. The prospects for inflation could eventually justify a cut in interest rates that was larger than 50 basis points. But while a 50 basis point cut would be a mild surprise, a 75 basis point cut would be a very big surprise, potentially damaging, rather than bolstering, confidence and causing volatility in financial markets. A 50 basis point cut now would be the better course this month.

35 The Governor invited members to vote on the proposition that the Bank’s repo rate should be reduced by 50 basis points to 4.0%. Eight members of the Committee (the Governor, Mervyn King, David Clementi, Christopher Allsopp, Kate Barker, Charles Bean, Stephen Nickell and Sushil Wadhvani) voted in favour. Ian Plenderleith voted against, preferring a reduction in the repo rate of 25 basis points.

36 The following members of the Committee were present:

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

Gus O’Donnell was present as the Treasury representative.

## **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 November in advance of its meeting on 7-8 November 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 advance estimate, US GDP in Q3 had fallen by 0.1% on a quarter earlier, following a rise of 0.1% in Q2. Consumption had grown by 0.3% and investment had fallen by 2.2%. Declining inventories had made a further negative contribution to growth. Non-farm payrolls had fallen by 415,000 in October, following a fall of 213,000 in September. The unemployment rate had stepped up to 5.4% in October, from 4.9% in August and September.

A3 The National Association of Purchasing Managers' (NAPM) index had fallen to 39.8 in October, its lowest level since February 1991. This compares with 47.0 in September. The Conference Board measure of consumer confidence had fallen to 85.5 in October, its lowest level since February 1994. It had been 97.0 in September. But the University of Michigan survey of consumer confidence for October had increased slightly to 82.7, from 81.8 in September.

A4 Retail sales values had fallen sharply in September, to 2.4% lower than a month earlier. Weekly measures of retail sales in October had shown little sign of a bounceback. Mortgage loan applications had risen sharply in October, but this had reflected higher levels of refinancing activity. Applications for house purchases had eased over the month. Home sales had fallen markedly in September. Sales of new houses had fallen by 1.4% compared with a month earlier, and sales of existing homes had fallen by 11.7% over the same period.

A5 Producer price inflation in the United States had dropped to 1.6% in the year to September, from 2.1% the month before. The measure of core producer price inflation, which excludes food and energy, had risen to 1.4%, from 1.3% in August. Annual headline and core consumer price inflation had both fallen by 0.1 percentage points since August, to 2.6% in September.

A6 Euro-area industrial production had increased by 1.1% in August. Manufacturing orders in Germany had fallen by 4.2% in September, having risen by 0.8% in August. Euro-area retail sales had increased by 0.3% in August. In Germany, retail sales had risen by 0.3% in August, after a fall of 0.1% in July. In France, consumer spending on manufactured goods had increased by 0.2% in September (a

rebound of 1.8% in Q3 relative to Q2). The unemployment rate in the euro area had remained at 8.3% in September.

A7 The euro-area manufacturing Purchasing Managers' Index (PMI) had fallen to 42.9 in October, from 45.9 in September. The service sector PMI had fallen to 46.7, from 49.0. Industrial confidence had fallen to -16 in October, from -12 in September. Consumer confidence had declined to -11, from -9. The west German IFO business confidence indicator had fallen to 85.0 in September, from 89.5 in August. Another confidence measure for Germany, the Centre for European Economic Research's (ZEW) economic sentiment index, had fallen to 9.8 in October, compared with 13.7 in September.

A8 Euro-area producer price inflation, which excludes the construction sector, had fallen to 0.7% in September, from 1.7% in August. Annual headline euro-area inflation, as measured by the harmonised index of consumer prices (HICP), had fallen to 2.5% in September, its fourth successive monthly decline.

A9 In Japan, industrial production had fallen by 4.3% in Q3, accompanied by a fall in inventories. Electrical machinery output had dropped by 25.6% in Q3, to its lowest level for six years. Nominal retail sales had fallen by 2.9% in the year to September (1.0% in the year to Q3) and the unemployment rate had reached 5.3% in September. The consumer price index had fallen by 0.8% in the year to September, slightly less than the preceding month. Growth of the monetary base in Japan had been 14.3% in October, following 14.2% in September. Growth in wider aggregates had been broadly unchanged.

A10 Since the Committee's previous meeting, the spot price for Brent crude oil had fallen by \$1.60 to \$19.10 per barrel. The *Economist* industrial commodity index had fallen by 3.8% and the *Economist* food commodity index by 0.6%.

A11 On 6 November, the Federal Open Market Committee had lowered the Federal funds target rate by 50 basis points, to 2%. At the time of the Monetary Policy Committee's meeting official interest rates had remained at 3.75% in the euro area. The expected path of future official interest rates in the United States and the euro area had fallen slightly.

A12 Over the month preceding the Committee's meeting, broad-based equity price indices had increased for the United States (the Wilshire 5000 had risen by 4.4%) and Europe (the Dow Jones Euro Stoxx index had risen by 11.2%), but had fallen in Japan (the Topix had fallen by 1.1%). Indices of high-technology stocks had increased by more (in the US and Europe) or had fallen by less (in Japan). After having risen sharply following the terrorist attacks of 11 September, measures of equity price

volatility implied by option contracts on the S&P 500 index had stabilised towards the upper end of their range since the Long-Term Capital Management (LTCM) crisis in 1998.

## **II Monetary and financial conditions**

A13 The twelve-month growth rate of notes and coin had risen to 7.3% in October, compared with September's growth rate of 6.7%. But the September figure had been depressed by the base effects of the fuel crisis a year earlier. Adjusting for this, the trend in notes and coin annual growth was broadly flat, suggesting that the 11 September attacks on the United States would have little impact on October retail sales.

A14 The twelve-month growth rate of M4 had risen to 8.0% in September. The twelve-month growth rate of M4 excluding other financial corporations (OFCs) had risen slightly to 7.4%. The twelve-month growth rate of M4 lending (excluding the effects of securitisations) including and excluding OFCs had weakened in September to 9.9% and 9.6% respectively.

A15 The twelve-month growth rate of households' M4 fell marginally to 8.6% in September. The twelve-month growth rate of households' M4 lending (excluding the effects of securitisations) rose to 10.5% – its highest rate since February 1991.

A16 The twelve-month growth rate of households' Divisia money had remained strong in Q3 at 9.3%, suggesting that the near-term outlook for retail sales would remain robust. However, flows into retail unit trusts had remained weak in Q3, particularly in September, probably reflecting falls in equity prices. Some of the continued strength of households' money might have been attributable to a switch of saving flows out of equity-based products.

A17 Within total lending to individuals, the annual growth rate of both secured and unsecured lending had risen to 9.4% and 12.9% respectively in September. The number of loan approvals for house purchase had fallen in September to 102,000 but the three-month growth rate of loan approvals on the same period a year ago had remained strong and above that of particulars delivered.

A18 The twelve-month growth rate of private non-financial corporations' (PNFCs') M4 had risen to 3.0% in September, while the twelve-month growth rate of PNFCs' M4 lending (excluding the effects of securitisations) had fallen to 7.1%.

A19 The twelve-month growth rate of other financial corporations' (OFCs') M4 had risen sharply to 10.1% in September, while the twelve-month growth rate of OFCs' M4 lending (excluding the effects of securitisations) had remained stable at 11.0%.

A20 Short-term nominal rates had fallen by between 38 and 55 basis points one to two years out since the Committee's previous meeting. Long-term nominal forward rates had also fallen back, broadly to the levels prevailing prior to the curve steepening in late September. Changes in real yields could account for some but not all of the fall in nominal yields.

A21 Inflation expectations derived from the yields on conventional and index-linked gilts had fallen at long maturities since the Committee's previous meeting. Inflation expectations of participants in HMT's survey for 2002 Q4 had fallen slightly, to 2.4% in October.

A22 Most retail rates had fallen in October, reflecting the mid-September reduction in the Bank's repo rate. The standard variable rate had fallen by 22 basis points and the two-year discounted variable mortgage rate had decreased by 28 basis points. Savings rates had also fallen in line with the repo rate reductions but quoted unsecured lending rates had remained unchanged over the month.

A23 Corporate spreads had fallen slightly since the Committee's previous meeting, but were still above levels prior to the 11 September terrorist attacks. The dispersion of spreads had risen. Spreads in utilities and financial corporations had fallen while those in general industrials had risen. By credit rating, spreads on high-quality corporate bonds had fallen while those for some lower-quality bonds had increased.

A24 All FTSE equity indices had picked up since the Committee's previous meeting: the FTSE All-Share had risen by 7.2% on the month and the FTSE 250 had risen by 9.3%. The recent divergence between the indices could in part be attributed to the sectoral weighting in the indices. The increase in the FTSE All-Share had been broad-based, although the information technology sector had increased more than other sectors.

A25 Since 3 October, the sterling exchange rate index (ERI) had risen by 0.7% to 107.2. This reflected a 0.8% depreciation of sterling against the US dollar, a 1.5% appreciation of sterling against the euro and a 0.5% depreciation of sterling against the yen. The short and longer-term Consensus Economics ERI profiles in October were similar to the profiles observed in June 2001.

### **III Demand and output**

A26 The preliminary estimate of GDP growth in 2001 Q3 had been 0.6%, compared with 0.4% in Q2. Service sector output growth had slowed slightly to 0.8% in Q3, from 0.9% in Q2. Within services, the distribution, hotels and catering sector had grown by 1.3% in Q3.

A27 Manufacturing output had fallen by 1.6% in September 2001, reversing the 1.2% rise that had occurred in August. For Q3 as a whole, manufacturing output had fallen by 0.8%. The fall had been more than accounted for by a fall of 5.6% in the output of the electrical and optical sector.

A28 In terms of the expenditure breakdown, retail sales volumes had grown by 0.2% in September, and by 1.5% in Q3 as a whole. Annual growth of retail sales had risen to 6.2% in Q3. Annual growth of private vehicle registrations had increased to 26% in Q3. This had followed an easing in growth in the first two quarters of 2001. However, the CBI Distributive Trades survey for October had suggested a decline in activity in the retail sector.

A29 There had been tentative signs of an easing in the housing market. Both the Nationwide and Halifax house price indices had fallen by 0.5% in October. Loan approvals data had also suggested a slight easing in housing market activity.

A30 The GfK survey balance of consumer confidence had fallen to -5 in October from -1 in September. There had been a particularly pronounced fall in households' confidence regarding future general economic developments. There had been a slight recovery in the MORI measure of consumer confidence in October, but the balance had remained low.

A31 Annual rates of return on capital had continued to fall in Q3. Rates of return in the manufacturing sector had remained weak, both in absolute terms and relative to the service sector. The BCC survey for Q3 had reported a weakening in investment intentions in the manufacturing and service sectors.

A32 Total goods export volumes had fallen by 1.4% and total goods import volumes by 2.9% in the three months to August compared with the three months to May. In Q3, exports of goods to non-EU countries had fallen by 1.5% on the previous quarter, while imports of goods had fallen by 4.1%.

A33 The BCC and monthly CIPS surveys had both suggested that there had been a further decline in service sector business confidence in the three months to September 2001. The decline had been modest, but the main part of both surveys had been conducted before the terrorist attacks on 11 September. The CIPS services survey for October had reported a more pronounced fall in service sector confidence and activity.

A34 For the manufacturing sector, the BCC survey had also suggested a moderate decline in confidence. But the CBI survey, which had been conducted after 11 September, had recorded a significantly larger fall.



#### **IV Labour market**

A35 According to the Labour Force Survey (LFS), employment had fallen by 19,000 in the period from June to August, compared with the previous three months. This had been the largest fall between adjacent non-overlapping quarters since the period from February to April 1993. The working-age employment rate had fallen by 0.3 percentage points in the period from June to August and had been 0.1 percentage points lower than a year earlier.

A36 Total hours had risen by 0.1% in the three months to August and had increased by 0.8% on the previous year. Average hours were broadly unchanged in the latest quarter but had been 0.2% higher than a year earlier.

A37 According to LFS data, the number of people entering employment, particularly from inactivity, had fallen in the three months to August, compared with the previous three months. The number leaving employment had also risen, reflecting an increase in the number of people who had moved from employment to unemployment.

A38 The fall in employment had been more than accounted for by a fall in temporary employees (down 110,000) and part-time employment (down 61,000).

A39 The overall CIPS employment index had fallen slightly in October compared with the previous month and had been below the 'no change' level since May. The index for construction had fallen sharply but had continued to indicate employment growth in the sector. The index for services had also fallen and had indicated lower service sector employment for the first time since February 1999. The index for manufacturing had shown signs of stabilising after falling sharply in recent months. Employment intentions, as recorded by the CBI manufacturing survey, had risen slightly in Q3 but remained below the average for the series. The BCC survey in Q3 had again shown a fall in employment intentions for both the manufacturing and service sector. The Manpower survey had shown that overall employment intentions had risen in Q3 compared with Q2. But the balance of firms trying to recruit had been lower than a year earlier.

A40 Recruitment difficulties in the service sector, as measured by the BCC survey, had been little changed in Q3 but the balance of firms reporting recruitment difficulties in the manufacturing sector had risen sharply, following a fall in Q2. The CBI Quarterly Industrial Trends Survey had shown that shortages of skilled labour had continued to fall in Q3.

A41 The Recruitment and Employment Confederation's index of job vacancies advertised in national newspapers had stabilised in September after its sharp falls in recent months. ONS data on job centre vacancies remained suspended.

A42 The LFS measure of unemployment had risen by 53,000 in the period from June to August, compared with the previous three months; the associated unemployment rate had risen to 5.1%. Over the same period, claimant count unemployment had fallen by 27,000 and had fallen a further 4,900 in September.

A43 Working-age inactivity had increased by 63,000 in the three months to August compared with the previous three months, raising the rate by 0.1 percentage points to 21.3%. The rise in working-age inactivity had been more than accounted for by women (up by 65,000).

A44 Headline whole-economy annual earnings growth, as measured by the Average Earnings Index (AEI), had been 4.5% in August, down 0.1 percentage points from July. Headline earnings growth in the public sector had risen by 0.1 percentage points to 5.7% but this had been more than offset by a 0.2 percentage point fall in the private sector, to 4.2%. Actual whole-economy earnings growth had fallen from 4.4% in July to 4.2% in August. Whole-economy regular pay growth (not seasonally adjusted) had remained stable at 5.2% in August. The contribution of bonuses reduced whole-economy earnings growth by 0.9 percentage points (not seasonally adjusted) in August.

A45 The Bank's twelve-month AEI-weighted mean pay settlement had fallen by 0.1 percentage points to 3.3% in September. There had been little additional news on settlements during the month.

## **V Prices**

A46 The Bank's sterling commodity price index had been unchanged between August and September. This had comprised offsetting movements in the prices of metals and domestic food on the one hand and the prices of fuels on the other. Prices of metals and domestic food had fallen by 7.6% and 0.8% respectively in September, whereas average fuel prices had risen by 1.2% over the same period. Due to base effects, the annual inflation rate of the index had fallen from 3.7% in August to -0.4% in September, the first time it had been negative since June 1999.

A47 In October, average sterling oil prices had been 17.0% lower than their average level in September, although the majority of the fall had occurred in September. Average sterling oil prices in October had been around 30% lower than they had been in the same month a year earlier.

A48 Manufacturing input prices had fallen by 1.0% in September. This had mainly reflected further falls in the prices of domestic food and imported materials. Annual input price inflation had fallen for the fifth consecutive month, to -6.2% in September from -3.0% in August. Looking ahead, the CIPS manufacturing survey had continued to point to falling input prices: the input price balance had fallen to 41.7 in October from 42.1 in September.

A49 Manufacturing output prices excluding duties (PPIY) had risen by 0.1% between August and September. But due to base effects, the annual inflation rate had fallen to 0.3% in September from 0.6% in August, its lowest since August 1999. Survey data had continued to point to weak output price inflation going forward. The CBI Quarterly Trends survey expected output price balance had fallen further to -21 in October from -16 in July.

A50 Annual RPIX inflation had fallen by 0.3 percentage points in September, to 2.3%. The fall had mainly reflected falls of 0.3 percentage points in both goods and services annual price inflation, to 0.5% and 3.9% respectively, and with particular lower contributions from petrol, leisure services, and clothing and footwear prices. On the RPI measure, annual inflation had fallen by 0.4 percentage points to 1.7% in September. Annual RPIY inflation had fallen to 2.8% in September from 3.1% in August, while annual HICP inflation had fallen to 1.3% in September from 1.8% in the previous month.

## **VI Reports by the Bank's Agents**

A51 The Bank's Agents had conducted a survey of around 190 businesses regarding their likely response to the terrorist attacks in the United States. The sample had been fairly evenly split between manufacturing and services businesses, with a small number of construction companies. Respondents had been asked to what extent their plans for investment, current expenditure, number of employees and output prices had changed as a result of the terrorist attacks on 11 September. The survey asked for companies' responses to the impact of the attacks themselves rather than business conditions prevailing before that date. It had not been clear, however, that all respondents had made this distinction. The results had shown a slight weighting towards downward revisions to investment plans, current expenditure, number of employees and output prices. However, the combination of 'too early to tell' answers and contacts' comments had also implied a high level of uncertainty, with intentions still very fluid. The proportions reporting changed investment plans had been similar to those in a survey conducted by MORI for CBI.

A52 Some companies that had indicated that their investment plans had been revised down significantly reported a freeze in capital expenditure. Some respondents who had revised investment plans up were buying video-conferencing facilities or investing opportunistically, to improve their competitive position. The most frequently cited area for current expenditure plans to have been revised

down had been travel. Reduced expectations for demand had led to downwards revisions in planned employee numbers. Only a small number of respondents had revised output prices as a result of the 11 September attacks.

A53 The events of 11 September had reinforced the cautious attitudes that had already been developing before that date. The general picture for manufacturing had continued to be negative, other than for consumer products for the domestic market. There had been further weakening in overseas markets, encompassing a reduction in demand from the United States, Europe and the Middle East. The rate of decline in output for domestic consumption had eased slightly. Some customers who had previously sourced from overseas were now reported to be looking to UK manufacturers to ensure continuity of supply. However, engineering firms had continued to report weak demand. Aerospace had been particularly affected by the events of 11 September, although the effect of a reduction in civilian aircraft orders would feed through quite slowly to other parts of the supply chain.

A54 Construction output had remained strong, but the outlook had become less certain and some speculative developments had been deferred. Some private sector clients had postponed or abandoned projects in hotels and airports, and this had led contractors to focus increasingly on public sector orders. Housebuilding had been steady but many builders had stopped purchasing additional land for development.

A55 The rate of increase in business services turnover had continued to slow and appeared to be growing more slowly than consumer services turnover for the first time in at least four years. Travel-related services, such as airlines, hotels, car hire firms and taxis had been significantly affected by lower demand from businesses and consumers.

A56 Growth in retail sales had continued to be strong following a brief dip after 11 September. However, the most recent reports from some Agencies had indicated slowing demand for big ticket items, and weaker-than-expected sales during school half-term holidays. Growth in sales of new cars had remained strong but might now have peaked. Used car stocks had risen as large numbers of fleet cars, many from car hire companies, were put on to the market. Business confidence had weakened and some investment plans had been deferred for review in early 2002 when demand conditions might have become less uncertain.

A57 Prices of input materials had generally been steady or falling. Many companies had not yet benefited from the falls in oil prices in the second half of September as they had hedged at higher levels. Service sector price inflation had eased, and margins had been squeezed by higher costs of insurance and pension provision. Reports of redundancies and slower growth in service sector employment had tempered private sector wage expectations. The increase in the National Minimum

Wage had had a small effect overall, but had raised pay bills by around 8% in sectors such as cleaning and catering.

## **VIII Market intelligence**

A58 Expectations of official interest rates implied by short sterling futures contracts had fallen during the period. The fall in implied rates partly reflected weaker-than-expected UK data including the CIPS services and CBI surveys, higher LFS unemployment and the falls in industrial production in September and GfK consumer confidence in October. By contrast, market participants had largely ignored the stronger-than-expected GDP figures for the United Kingdom in Q3. Overseas data and monetary policy decisions had also led to falls in interest rate expectations over the period, with the release of weaker-than-expected US durable goods orders, US consumer confidence, the US NAPM manufacturing survey and the declines in US employment and German IFO data.

A59 Interest rate uncertainty had fallen during the period for both the United Kingdom and the United States. In addition, options contracts had on 7 November implied a negative risk to the central expectation implied by the June 2002 short sterling futures, in contrast to the position in the United States. Money market instruments on 7 November had fully priced in a 25 basis point reduction in the Bank's repo rate at the next day's MPC decision and had suggested around a 30% probability attached to a 50 basis point reduction. By contrast, economists surveyed by Reuters on 31 October had attached a mean probability of 34% to a 'no change' in the repo rate, with nearly all who forecast a change expecting a reduction of 25 basis points. Short sterling futures contracts implied an expectation that the Bank's repo rate would be lowered to around 3¾% by early 2002.

A60 Since the Committee's previous meeting, movements in exchange rates had been relatively small, and implied volatilities had fallen back towards their lows for the year after spiking up following the terrorist attacks in the United States. The dollar had strengthened a little over the period in spite of a perceived worsening in the outlook for the US economy; investment bank measures of capital flows suggested renewed demand for dollar assets. The euro depreciated as euro data were generally weaker than expected. Sterling appreciated by 0.7% in effective terms, its depreciation against the dollar being more than offset by an appreciation against the euro.