

Publication date: 17 April 2002

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# MINUTES OF MONETARY POLICY COMMITTEE MEETING 3 and 4 April 2002

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These are the minutes of the Monetary Policy Committee meeting held on 3 and 4 April 2002

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0204.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 8 and 9 May will be published on 22 May 2002.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 3-4 APRIL 2002**

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

### **The world economy**

2 Recent information about the world economy, particularly that from the United States, was again encouraging. The estimate of US GDP growth in the fourth quarter of last year had been revised up, to +0.4%, and corporate profits had recovered sharply on the quarter. Output of the information and communications technology (ICT) sector had started to increase and inventories might no longer be falling. Retail sales in January and February suggested a continuing strong contribution from consumption, though they might have eased in March; and consumer confidence had improved sharply on both main survey measures. All this suggested that activity in the United States was indeed recovering rapidly. The Consensus forecast for growth in 2002 was now over 2%, whereas only two months ago it had been below 1%.

3 The Committee, in reviewing the US recovery and the factors underlying it, noted the speed of the turnaround in the position of, and prospects for, the ICT sector. This was reflected also in the strength of production of ICT goods elsewhere – for example, in Korea and Taiwan – and suggested that the close economic links which had been evident in the downturn would similarly characterise the recovery. The United States had also benefited from a larger, and perhaps more predictable, stimulus from both monetary and fiscal policy, the effects of which were now clear to see (notably in household consumption). Output growth of over 3% per annum was still believed by many commentators to be sustainable there, so – given its recent level – a return of output growth to trend would be consistent with a stronger recovery in the United States than elsewhere.

4 There were, nonetheless, unresolved questions about the sustainability of this recovery, at least at the pace seen in recent months. While expected future interest rates in debt markets had risen, the equity market had responded very little to the strong data and survey indicators: it might be that the recovery had been anticipated in equity markets, and so was already reflected in equity market prices. In addition, the recovery in corporate profits in the fourth quarter had been from a very low level, and

was associated with cost-cutting in the wake of the slowdown and also the terrorist attacks in September. Profits were still by no means strong. There was little sign of a pick-up in investment, which would be important for the sustainability of recovery, and it was not yet clear that the latest data reflected any more than the final stage of the inventory cycle. Consumption growth, though it had so far remained resilient, could falter given the accumulating debt burdens, particularly if asset prices were to fall. Over the past six months, consumption growth had been sustained, in part, by tax cuts and mortgage refinancing. Both factors were likely to be less supportive over the rest of this year.

5 An additional concern, both for the US recovery and for the prospects for world activity and inflation more generally, was the strengthening of around 35% in oil prices over the past two months. They had now returned to levels seen before the attacks in the United States last September and, if they remained at these levels or continued to rise, would both increase inflation and reduce real incomes, which could lower consumption growth, thus slowing the recovery. Oil prices had increased much more than other commodity prices, which suggested that the recent movements were mainly supply-driven; and the tensions in the Middle East meant that prices could remain high. On the other hand, there was still significant excess capacity amongst OPEC producers and additional demand could – and, given some producers' revenue needs, probably would – be accommodated.

6 By contrast with the evidence of recovery in the United States, the immediate outlook for the euro area and Consensus forecasts for the region were little changed. GDP had fallen a little in the fourth quarter, following weak growth in the third, and there were important differences within the euro area in the second half of last year, with output, for example, lower in Germany but higher in France and Spain. Survey indicators, though again generally stronger, continued to point to a slower recovery than in the United States, and the current market forward curve also implied a rather less rapid increase in euro-area official interest rates. This was consistent with growth in the euro area having fallen less far below trend. It was likely that – as in the downturn – the euro area would lag any US recovery and that recovery there would need largely to be export-led. Measures of core inflation in the euro area were also continuing to edge higher, despite the slowdown in activity growth last year.

7 The economic news from Japan was mixed: despite some more positive signs, the latest Tankan survey results had been disappointing.

## Money, credit and asset prices

8 Money and credit data continued to reflect the differences between the positions of the household and corporate sectors. Household borrowing grew by 11.4% in the year to February, continuing its acceleration since early last year. Mortgage loan approvals, and household debt to income ratios, were also up again, while the growth of household money holdings had moderated. The annual rate of house price inflation, as measured by the Halifax and Nationwide indices, was about 15% in February, and the price expectations balance in the survey by the Royal Institution of Chartered Surveyors remained high. All were consistent with survey evidence of consumer optimism and with the continued strength of consumption growth.

9 The strength of house prices was the most notable feature of these data, and contrasted with views a year ago that house prices would continue to decelerate. One possible explanation was that this largely reflected the cash flow effects of lower interest rates: the reductions in rates during 2001 had had marked effects on measures of affordability and allowed households to take on higher levels of mortgage debt for the same nominal servicing cost. This could relax the credit constraints which were faced by some households when nominal interest rates were higher, and so might support a higher equilibrium ratio of house prices to earnings. Alternatively, even if the higher level of debt might not be sustainable in the long run, it would take time for households to learn that the real cost had not fallen to the same extent. It was, however, not clear whether this provided a complete explanation, nor whether such nominal debt servicing effects would persist. The money markets already discounted an increase in official interest rates, which had to some extent been reflected in the cost of fixed rate mortgages. There was no sign that this had affected house prices, although the interest rate on new two-year fixed-rate mortgages was only about 30 basis points above its recent low, and so was still significantly below its average over the past five years. Nevertheless, there was little evidence of unusual levels of borrowing at very high loan-to-value ratios, or of distress. The ratio of house prices to earnings was not yet unduly high by historical standards. Competition amongst mortgage lenders had in addition increased the availability of mortgages and improved the terms on which they could be obtained.

10 By contrast with this buoyant household sector picture, corporate money and credit indicators suggested little change in corporate activity. Corporate deposit growth continued to increase, but growth in lending to corporates had been slowing.

11 Inflation expectations implied by the market prices of conventional and index-linked gilts had risen noticeably at all maturities. Survey information on shorter-term expectations, however, did not fully corroborate this market-based measure and it seemed probable (despite the similar changes in US rates) that the extent of the rise reflected technical factors rather than a genuine change in the market's inflation expectations. But such measures of inflation expectations, in the United States and United Kingdom alike, had for some time appeared to be more volatile than was readily explicable in terms of underlying economic fundamentals.

### **Demand and output**

12 Revised data on GDP last year showed a pattern of expenditure which was now more consistent with survey and other evidence. There was on the one hand persistently strong consumption growth and a strengthening contribution from Government spending, and on the other consistently weak business investment. The level of GDP at factor cost – on which the measure of pressure of demand on capacity in the Committee's forecasting model was based – had however been revised down and was now estimated by the ONS to have been about 0.4 percentage points lower in the fourth quarter of last year than in the Committee's central projection at the time of the February *Inflation Report*. Much of this revision to the level of GDP had been in the most recent quarters, and so was less likely to contain news about the economy's sustainable level of potential output than would revisions to earlier data. How it should be interpreted would be an important issue in the coming forecast round.

13 Despite the apparent worldwide recovery in ICT output, it was difficult to find evidence in the data that there had yet been a corresponding recovery within manufacturing activity in the United Kingdom: manufacturing output had fallen in each quarter last year, and by a further 0.4% in January; and that latest fall had been more than accounted for by a fall of more than 6% in output of the electrical and optical engineering sector, which should be among the first to benefit from a worldwide ICT recovery. Survey evidence was more encouraging and there were signs of improvement in manufacturing orders. To the extent that these surveys were qualitative and so did not give sufficient weight to the scale of the output movements in the electrical and optical engineering sector, however, this evidence might be giving false comfort. And whereas investment data had previously suggested a sharp fall in business investment in the fourth quarter, which would have been consistent with a more rapid recovery in the early part of this year, the revised data showed a flatter profile and might therefore imply a correspondingly shallower recovery.

14 Elsewhere, construction activity was buoyant. There had been a downward revision to services output growth in the second half of last year, but survey evidence from the Chartered Institute of Purchasing and Supply (CIPS) and from the CBI suggested that services activity was growing strongly again and that optimism in financial and business services was also recovering. While retail sales had risen sharply in February, the three-month growth rate had eased though the twelve-month growth rate had not done so. Consumer confidence had weakened a little.

### **The labour market**

15 Conditions in the labour market remained surprisingly benign. Unemployment was rising less strongly than the Committee had projected in February (if at all, on the claimant count measure) and there had been little change in the inflows into unemployment, which were still below the average of last year. At the same time, earnings growth was rather weaker than projected and was currently well below last year's levels. This was accounted for by two factors: first, the rate of growth of regular pay per head had eased, driven in large part by falls in paid overtime and in average hours; second, there was a substantial negative contribution from bonuses, substantial in part because the share of bonuses in overall pay was well above average at this time of year. Pay settlements too were rather lower than a year ago. If unemployment remained low and activity picked up, average hours – and with it, regular pay per head – could recover quite quickly. The size of the bonus contribution should also fall, even if the rate of fall of bonuses itself did not ease, as the main bonus season passed. But it was difficult to judge the likely implications of a recovery in nominal earnings growth for prices, as productivity growth had also been very weak in recent months. It was plausible that productivity would recover as activity picked up and any hoarded labour was again used to its full potential.

16 One suggested explanation of these outturns was that remuneration arrangements had become more flexible in recent years. Bonuses were now a more important component of pay and, if they were more responsive than regular pay to changes in corporate profitability, it would be reasonable to expect that there would be more volatility in hours worked and in earnings per head, and less in heads employed. Others noted, however, that greater labour market flexibility could also be associated with lower hiring and firing costs, which would suggest greater variability in numbers employed in response to shocks. There was a marked contrast, too, between this UK experience and the substantial labour shedding in the United States in response to the downturn in demand. It was surprising that inflows to unemployment had not picked up here. This suggested either that announced redundancies had not yet been implemented, or that they were not in fact large relative to recruitment elsewhere in

the economy. There was also widespread evidence of on-the-job searching by, and outplacement assistance to, those about to be made redundant. So some job losses might not be manifested in unemployment at all.

### **Prices and costs**

17 Annual inflation in February on the RPIX measure had reversed more than half of its sharp rise in January, illustrating again the extent to which measured inflation was susceptible to short-term volatility which had little relationship with underlying inflationary pressures in the economy. Other measures of inflationary pressure, such as domestically-generated inflation and the GDP deflator, and measures of retail prices which excluded volatile components or tax effects, differed quite widely from each other and from the targeted measure. And, as with any measure of inflation, RPIX itself depended on the particular measures of the prices included in it. The housing depreciation component, for example, was based on the DTLR index of house prices. This frequently differed substantially from other possible measures of house prices. All this illustrated the familiar point that it was necessary to look through small differences in measured inflation and to ignore its month-to-month volatility, in order to assess the extent of underlying inflationary pressure.

### **Other considerations**

18 The Chancellor was to present his Budget on 17 April and the Committee would as usual be briefed on it by Treasury officials shortly in advance. Its implications for output and inflation would be considered fully in the context of preparing the projections for the May *Inflation Report*.

19 The pattern of market interest rates, and surveys of market opinion, indicated that there was very little market expectation that the Committee would decide to change the repo rate this month.

### **The immediate policy decision**

20 The Committee agreed that the recovery in the United States was emerging more quickly and more strongly than could reasonably have been expected six or even three months ago. Earlier hopes of recovery in the latter part of 2001 had been put back, in the wake of the terrorist attacks of 11 September, to at best the first half of this year. That hoped-for recovery now seemed already to be established. Sentiment was improving globally as a result, and forecasts of growth this year were

being revised upwards. The downside risks to the world economy in the near term had become much less acute, and the overall world outlook was as encouraging as could have been hoped at the time the Committee's projections were agreed for the February *Inflation Report*.

21 Nevertheless, sustained recovery – even in the United States – was by no means yet assured. Though the turnaround in ICT output, and the bounce-back in US corporate profits, were encouraging, it was still possible that they simply reflected the inventory cycle. The level of corporate profits was still weak. There was little sign so far of a recovery in investment and this would be important to future growth prospects. And earlier concerns about the imbalances in the US economy and how they might be corrected remained relevant to the medium-term outlook.

22 One particular concern was the strengthening in oil prices in the past two months, and the recent resurgence of tension in the Middle East. Were oil prices to continue to rise, there could be significant dampening effects on global activity further out. To this extent, despite the more reassuring outlook for this year, the upside risks to inflation and the downside risks to the world outlook in 2003 had increased. A further uncertainty was the outlook for the euro area, which was more directly relevant for UK external demand than was activity in the United States. Though sentiment in the euro area had improved as the US outlook had strengthened, the data did not as yet show evidence of much improvement there.

23 In the United Kingdom too, the news on the month was mixed. Consumption growth remained strong and continued to underpin demand. Leading indicators such as household credit and house prices remain strong, and unemployment had picked up less than had been expected. But the strong rise last year in real post-tax wages was unlikely to persist, as the beneficial effects of past tax changes and improvements in the terms of trade would unwind and pay settlements were now lower than a year ago. In addition, to the extent that the rapid increase in durables purchases represented a stock adjustment reflecting households' perceived improvements in permanent income, their contribution to consumption growth was likely to ease, though it was difficult to be confident about when this might happen. Income gearing remained moderate by historical standards. All agreed that the case for increasing interest rates in order to restrain consumption growth was not yet pressing.

24 The level of GDP at factor cost in the fourth quarter of last year was now estimated by the ONS to be significantly lower than projected in the February *Inflation Report*, and only 1.2% higher than in the fourth quarter of the previous year. On its own, this would, if interpreted mechanically, imply a



rather weaker inflation projection, as it suggested that there was a larger margin of excess capacity in the economy than had previously been thought. The reliance that should be placed on this GDP figure, given the inevitable uncertainties surrounding early estimates and the factor cost adjustment, was however limited and it would need to be reviewed carefully alongside other evidence in preparing the projections for the May *Inflation Report*. Forward-looking surveys of business activity were encouraging, but investment had fallen steadily through 2001 and investment intentions had so far shown only modest increases. Members agreed that, while manufacturing output might be about to recover, there was not yet conclusive evidence that it had begun to do so.

25 Domestic inflationary pressures remained subdued, despite the fact that the labour market had eased rather less than had been expected. It remained an open question how that market would respond as activity growth started to pick up: some members detected signs that, despite recent easing, pay pressures were building again and would increase as some of the other factors which had boosted the growth of the real consumption wage began to ease; others suggested that recent labour hoarding provided scope for productivity to recover as demand increased, though the extent of that slack remained to be seen. The net implications for unit wage costs, and so for inflationary pressures, were far from clear.

26 For some members, recent news taken as a whole added some weight to the arguments for an increase in rates, though it was by no means decisive; most, however, took a more neutral view.

27 The Governor invited members to vote on the proposition that the Bank's repo rate should be maintained at 4.0%. The Committee voted unanimously in favour of the proposition.

28 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 28 March in advance of its meeting on 3-4 April 2002. 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 GDP growth had been revised up to 0.4% in 2001 Q4, from 0.3% in the preliminary release. Pre-tax profits, including adjustments for inventory valuation and capital consumption, had risen by 17.9% in 2001 Q4. The growth forecast for 2002 from the Consensus Economics survey had been revised up to 2.1% in March from 1.6% in February. Industrial production had risen by 0.4% in February, and within that manufacturing output had risen for the second consecutive month. Output in the information and communication technology (ICT) sector had risen by 1.2% in February. Nominal business inventories had risen by 0.2% in January and strong growth in sales had led to a further decline in the stocks-sales ratio. New orders for non-defence capital goods had risen by 4.6% in February, reflecting a large increase in orders for aircraft. The Institute for Supply Management (ISM) manufacturing index had increased in March, to 55.6, from 54.7 in February. The non-manufacturing ISM index had fallen to 57.3 in March from 58.7 in February.

A3 The unemployment rate had fallen to 5.5% in February, from 5.6% in January, while non-farm payrolls had risen by 66,000. Labour productivity growth in 2001 Q4 had been revised up to 1.3%, from 0.9%. This had been the strongest rise since 2000 Q2. The fall in unit labour costs in 2001 Q4 had been revised to 0.7%, from 0.3%.

A4 The University of Michigan consumer confidence index had risen to 95.7 in March, from 90.7 in February. The Conference Board consumer confidence index had risen to 110.2 in March, from 95 in February. Real consumption had risen by 0.5% in February.

A5 Annual consumer price inflation in the United States had been unchanged in February, at 1.1%. Annual core consumer price inflation, excluding food and energy, had also been unchanged, at 2.6%.

A6 Euro-area GDP had fallen by 0.2% in 2001 Q4, compared with growth of 0.2% in 2001 Q3. Private consumption, government consumption and net trade had made positive contributions to growth while investment and changes in stocks had made negative contributions. German industrial production had risen by 0.4% in January.

A7 The euro-area Purchasing Managers' Index for manufacturing had risen to 50.0 in March, from 48.6 in February. This was the first time since March 2001 that the index had not signalled a contraction. The European Commission's measure of industrial confidence in the euro area had risen to -11 in March, from -14 in February. Consumer confidence had been unchanged at -9 in March. In Germany, the Ifo index had risen to 91.8 in March, from 88.5 in February. French consumer spending on manufactured goods had risen by 0.4% in February, following a fall of 0.5% in January.

A8 The euro-area harmonised index of consumer prices (HICP) had risen by 2.4% in the year to February, down from 2.7% in January. HICP inflation in Germany had risen to 1.9% in the year to March, from 1.8% in February, and the preliminary estimate for euro-area HICP inflation had been 2.5%.

A9 In Japan, GDP had fallen by 1.2% in 2001 Q4. Consumption had risen by 1.9% on the quarter while total investment had declined by 10% on the quarter. Non-residential investment had fallen by 12.0% on the quarter. Corporate profits had fallen by 31.4% in the year to 2001 Q4. Export volumes had fallen by 5.5% in the year to February, which had represented a considerable slowing in the pace of decline since the end of 2001. Japanese industrial production had risen by 1.3% in February, while inventories had fallen by 0.6% in February.

A10 The spot price for Brent crude oil had risen to about \$27 per barrel, an increase of about \$4.50 since the Committee's previous meeting. The *Economist* all-item dollar price index had risen by 1% since the Committee's previous meeting. The industrial metals sub-index had fallen by 1%, while the non-food agricultural sub-index had risen by 3%. The food sub-index had risen by 1% over the same period.

A11 The Wilshire 5000 index had fallen by 2.7% since the Committee's previous meeting. The FTSE All-Share, Topix and Dow Jones Euro Stoxx indices had risen by 0.5%, 1.0% and 0.5% respectively since the Committee's previous meeting.

## II Monetary and financial conditions

A12 The twelve-month growth rate of notes and coin had fallen to 7.5% in March, from 7.7% in February. The three-month annualised growth rate had fallen to 6.6% in March, from 8.0% in February. The twelve-month growth rate of M4 had risen to 6.2% in February, from 5.8% in January. The twelve-month growth rate of M4 lending (excluding the effects of securitisations) had fallen to 8.3% in February, from 9.0% in January. The twelve-month growth rate of households' M4 had remained unchanged at 8.0% in February. The twelve-month growth rate of households' M4 lending (excluding the effects of securitisations) had continued to rise in February, to 11.4%, the highest growth rate since 1990 Q4. Within total lending to individuals, the annual growth rate of secured lending had risen slightly to 10.4% in February, and the annual growth rate of unsecured lending had risen to 15.0%, from 14.5% in January. The number of loan approvals for house purchase had risen in February. The estimated household debt to income ratio had risen somewhat in 2001 Q4, while households' capital gearing had been broadly flat. The ratio of households' interest payments to disposable income had declined in 2001 Q4.

A13 The twelve-month growth rate of private non-financial corporations' (PNFCs') M4 deposits had risen to 9.1% in February; this had been the highest growth rate since January 2001. The twelve-month growth rate of PNFCs' M4 lending (excluding the effects of securitisations) had fallen further to 5.4%, from 6.8% in January. PNFCs had raised an average of £3.4 billion in total external finance in January and February, compared with an average monthly flow of £3.3 billion in 2001 Q4.

A14 The corporate debt to profits ratio was estimated to have risen slightly in 2001 Q4, while corporate capital gearing at market value was estimated to have fallen slightly. Corporate income gearing had fallen somewhat in 2001 Q4.

A15 The twelve-month growth rate of other financial corporations' (OFCs') M4 deposits had risen to -0.1% in February, from -1.5% in January. The twelve-month growth rate of OFCs' M4 lending (excluding the effects of securitisations) had fallen to 3.5% in February, from 5.7% in January.

A16 Expected short-term nominal rates for one year ahead had risen by 19 to 25 basis points since the Committee's previous meeting. Long-term nominal forward rates had risen over the same period, by 9 basis points at 15 years. Yields on index-linked gilts had fallen at all maturities since the

Committee's previous meeting, by 22 basis point at 15 years.

A17 Inflation expectations derived from conventional and index-linked gilts had risen by 37 basis points at ten years since the February *Inflation Report*. The HMT monthly survey in March had shown that professional forecasters had increased their expectations of the annual inflation rate in 2002 Q4 to 2.3%, from 2.1% in February, but their expectations of the annual inflation rate in 2003 Q4 had been unchanged at 2.3%. This survey was taken before the RPI data release on 19 March.

A18 The average quoted standard variable rate for mortgages had remained unchanged in March. The two-year discounted rate had risen by 14 basis points. The two-year fixed mortgage rate had remained unchanged. Credit card rates had fallen by 65 basis points in March. The share of fixed rate mortgages in new mortgages had been 37% in February, according to Council of Mortgage Lenders' (CML) data.

A19 The Merrill Lynch aggregate index of investment grade sterling corporate bond spreads had fallen slightly since last month, and spreads for the telecoms sub-index had fallen. Issuance of non-gilt sterling bonds in March had been strong, with a continued emphasis on long bonds.

A20 Most UK equity indices had remained little changed since the Committee's previous meeting, although the information technology (IT) and non-cyclical services sector indices had fallen. 23 profit warnings had been issued in March, the lowest since October 2000. The skew of FTSE 100 returns derived from options prices had become less negative than in the immediate aftermath of the terrorist attacks on 11 September.

A21 Since the Committee's previous meeting, the sterling exchange rate index (ERI) had risen by 0.6% to 107.3. This reflected a 1.1% appreciation against the US dollar and a 0.4% appreciation against the euro. The implied correlation between sterling and euro movements against the dollar had continued to rise. The latest Consensus Economics survey (11 March) had shown a further rise in the profile of the expected sterling exchange rate index two years ahead.

### **III Demand and output**

A22 In the 2001 Q4 National Accounts, quarterly real GDP growth at market prices had been unrevised from the previous release, at 0.0% in 2001 Q4. However, annual growth had been revised

down slightly to 1.6% from 1.7%. The National Accounts included revisions to GDP and its components from 2000 onwards. The net impact of those revisions had been to lower the level of GDP at market prices in 2001 Q4 by 0.2%. GDP at factor cost had fallen by 0.1% in Q4, and had grown by 1.2% on an annual basis.

A23 On the output measure, GDP growth at basic prices had been revised down to  $-0.1\%$  in Q4 from  $0.0\%$  in the previous release. Together with downward revisions to earlier data, this meant that the level of GDP on this measure in 2001 Q4 was  $0.4\%$  lower than had previously been estimated. Service sector output growth in Q4 had been revised down to  $0.5\%$ , from  $0.7\%$ , reflecting in large part a downward revision to growth of the Business Services and Finance sector to  $0.7\%$  from a previous estimate of  $1.2\%$ . Manufacturing output growth in Q4 had also been revised down, from  $-1.7\%$  to  $-1.9\%$ .

A24 On the expenditure measure, quarterly final domestic demand growth in Q4 had been revised up to  $0.9\%$ , from  $0.4\%$  in the previous release. The upward revision had been due to upward revisions to whole-economy investment and government consumption, which had more than offset a downward revision to consumption.

A25 Consumption growth in Q4 had been revised down to  $0.9\%$  from  $1.1\%$ . This growth was driven by strong growth – of  $4.0\%$  – in spending on durable goods. Revisions to past consumption data had lowered the level of consumption in 2001 Q4 by  $0.4\%$  from the previous estimate.

A26 Whole economy investment growth in Q4 had been revised up to  $+0.5\%$  from  $-1.8\%$  in the previous release. The revision to whole economy investment growth in Q4 had largely been accounted for by an upward revision to business investment growth, from  $-3.2\%$  to  $-0.3\%$ . But revisions had changed the profile of business investment in 2001: it was now estimated to have fallen in all four quarters. Government investment had risen by  $13.9\%$  in 2001 Q4, and government consumption had risen by  $1.4\%$ , revised up from a rise of  $0.2\%$  in the previous release.

A27 The contribution of inventories to quarterly GDP growth in Q4 had been revised down to  $-0.5$  percentage points from the previous estimate of a contribution of  $+0.1$  percentage points. Within this, underlying stocks had contributed  $-0.2$  percentage points to GDP growth, while the alignment adjustment had contributed  $-0.3$  percentage points. Domestic demand growth had been unrevised at

0.5% in Q4.

A28 Both export and import growth had been revised up in 2001 Q4. Total exports of goods and services had fallen by 1.2% in Q4, revised up from a fall of 1.8%, while imports had risen by 0.2%, compared with a fall of 0.2% in the previous release. However, the two revisions had largely offset, so the contribution of net trade to GDP growth had been unrevised at -0.5 percentage points.

A29 Households' real post-tax total income had risen by 0.8% in Q4, similar to growth in recent quarters. The saving ratio had fallen slightly to 5.2% in Q4, from 5.3% in Q3. Households' net financial balance had been revised, to close to zero throughout 2001.

A30 The gross operating surplus of public and private corporations (excluding the alignment adjustment) had fallen by 1.7% in Q4, following a rise of 4.4% in Q3. There had been a slight reduction in the corporate sector's net financial deficit in Q4, to just over 2% of GDP. Given the broadly flat household net financial balance, this reduction had resulted in the total private sector net financial deficit narrowing slightly in Q4. The general government net financial balance had turned negative in Q4 for the first time since 1997.

A31 The current account deficit had widened sharply to £7.6 billion in Q4, from £2.4 billion in Q3.

A32 Turning to 2002 Q1 data, retail sales volumes had risen by 1.5% in February, following a fall of 0.3% in January. The March CBI Distributive Trades survey had reported a slight easing in the growth of retail sales, the balance falling to +31 from +33 in February. The GfK measure of consumer confidence had fallen slightly in March, to +3 from +5 in February, but remained around the level it had averaged in the first half of 2001.

A33 The Nationwide house price index had risen by 0.9% in March, following a rise of 1.6% in February. On an annual basis, house prices had grown by 13.8% in March. The Halifax house price index had risen by 0.4% in March, and by 16.0% on an annual basis. Particulars delivered had risen by 7,000 to 128,000 in February.

A34 Manufacturing output had fallen by 0.4% in January. This fall had been more than accounted for by a fall of 6.4% in the output of the electrical and optical engineering sector. Evidence on the prospects for the manufacturing sector had been somewhat mixed. The Chartered Institute of

Purchasing and Supply (CIPS) manufacturing survey had shown an increase in manufacturing output and orders in March, following rises in February. The CBI Monthly Industrial Trends survey had also reported a rise in expected output in March, but had not yet seen a similar pick-up in orders following the falls in 2001.

A35 The CIPS services survey had indicated strong growth in activity and new business in March, following renewed growth in February.

#### **IV Labour market**

A36 According to the Labour Force Survey (LFS), employment had increased by 23,000 in the three months to January compared with the previous three months. The working age employment rate had decreased by 0.1 percentage points to 74.5%, but had remained largely unchanged since May 2001. Although employment in heads had been little changed, employment in terms of total hours had fallen by 0.5%. Average hours worked had decreased by 0.6% in three months to January, compared with the previous three months. The fall in usual hours over that period had been concentrated among those who had worked the longest hours.

A37 The CIPS employment survey for March had suggested a largely unchanged employment picture. The manufacturing, construction and services indices had all ticked up slightly, but only the construction employment balance had been positive. The Andersen/REC Report on Jobs for March had indicated that the availability of agency staff had continued to increase, but that increases were less widespread than in recent months.

A38 The LFS measure of unemployment had risen by 8,000 in the three months to January compared with the previous three months. Over the same period, claimant-count unemployment had increased by 8,800; but it had fallen by 5,000 in February. The unemployment rate had been unchanged on both measures.

A39 Inactivity among those of working age had risen by 41,000 in the three months to January and the rate had risen by 0.1 percentage points to 21.4%. This rise had been more than accounted for by a rise in male inactivity, which had increased by 49,000.



A40 The official ONS measure of annual growth in productivity per head, based on productivity jobs and GDP at basic prices, had fallen 0.2 percentage points to 0.8% in the three months to December. However, annual growth in productivity per hour had recovered by 0.5 percentage points to 1.1% over the same period. The annual growth in the official ONS measure of unit wage costs had fallen by 0.3 percentage points to 3.3%.

A41 Headline (three-month average basis) whole-economy annual earnings growth had declined by 0.7 percentage points to 2.7% in the year to January. However, actual whole-economy earnings growth had increased by 0.3 percentage points to 2.4% in the year to January. Whole-economy regular pay growth (not seasonally adjusted) had declined by 0.2 percentage points to 4.2% in the year to January, 1 percentage point lower than its level last summer. The pick-up in average earnings growth had been accounted for by an easing of the negative bonus contribution to -1.8% in January from -2.3% in December, which reflected the smaller share of bonuses in total pay in January, rather than an easing in the rate of decline of bonuses themselves.

A42 The Bank's twelve-month AEI-weighted mean measure of pay settlements had edged down 0.1 percentage points to 3.3% in February. Among the set of firms where deals could be matched with those agreed a year earlier, the average settlement in the three months to February had been 2.8%. This had been 0.4 percentage points lower than over the same period a year ago.

## **V Prices**

A43 There had been a sharp increase in oil prices in March. Sterling oil prices had, on average, been over 15% higher in March than their average level in February, taking them to a level broadly similar to that a year ago.

A44 Manufacturing input prices had risen by 0.2% in February. This had mainly reflected increases in the prices of crude petroleum products. Due to base effects, annual input price inflation had fallen to -7.2% in February, from -6.1% in January. The CIPS manufacturing survey had suggested that input price pressures would continue to be weak going forward. Although the input price balance had risen to 43.7 in February, from 39.8 in January, it had remained significantly below the no-change level of 50.

A45 Manufacturing output prices excluding duties (PPIY) were unchanged in February, while the annual inflation rate had risen by 0.2 percentage points to 0.2%. Survey data had continued to point to subdued output price inflation going forward. The Confederation of British Industry Monthly Trends survey expected output price balance had risen modestly to –16 in March, from –20 in February.

A46 The annual inflation rate of the GDP deflator at market prices had been revised down slightly to 2.7% in 2001 Q4, from 2.8% in the previous release. Within this, the annual inflation rates of the household consumption and government deflators had been revised to 1.7% and 4.5% respectively. The annual inflation rate of the import price deflator had been revised up marginally to –2.7%, from the initial estimate of –2.8%.

A47 Annual RPIX inflation had fallen 0.4 percentage points to 2.2% in February, reversing more than half of the sharp rise in January. The fall had mainly reflected lower annual goods price inflation, which had fallen to 0.1% from 0.5% in January. Annual services price inflation had fallen slightly to 4.5% in February. Annual inflation on the RPI and RPIY measures had fallen by 0.3 percentage points to 1.0% and 2.7% respectively in February, while annual HICP inflation had fallen to 1.5%, down from 1.6% in the previous month.

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

A48 The Bank's regional Agents had reported that the rate of decline in manufacturing output for the domestic and export markets had eased since 2001 Q4. Contacts had reported an improvement in enquiry levels but these enquiries had not yet translated into orders. The increasingly last minute nature of orders had implied that any rise in output might be rapid. Because stocks were low, however, it was thought possible that any pick-up in output might not be sustained after firms had rebuilt stocks. Output for the commercial aerospace sector had been reported as unlikely to rise until the end of 2003.

A49 The recovery in business services turnover had continued, but was not universal. Advertising levels had been lower than a year ago, apart from for the public sector. Consumer services had continued to record modest growth. Leisure and health clubs, bars and restaurants, and summer holiday bookings had all continued to be buoyant. Retail sales growth had probably peaked and confidence among retailers had weakened, but any slowdown in sales growth had so far been marginal. The car and housing markets had also remained buoyant. Contacts had expected weaker year-on-year

growth rates for car and retail sales from March onwards due to the strength of sales in the equivalent months last year.

A50 In the labour market, the rate of manufacturing job losses had eased slightly since 2001 Q4. Large-scale recruitment had continued in the public and some parts of the service sector. Contacts had reported that voluntary labour turnover had lessened. Some manufacturers had continued to hoard labour but were uncertain as to how long this could continue in the absence of a decisive pick-up in orders. Pay pressure had remained subdued overall. Pay freezes and deferral of pay reviews had become increasingly common and some employers had made increased contributions to employees' pensions instead of awarding pay increases.

A51 Material input costs had generally continued to be flat, while overheads had continued to rise. Output and retail prices had shown little increase but there had been some reports of limited service-sector price increases.

A52 The Bank's Agents had conducted a survey of around 75 firms in ICT manufacturing regarding their expectations for output. Respondents had been asked how they expected output of computer and telecommunications hardware and components from their UK plants to change during the next 12 months; they had been asked how they expected output by their UK plants destined for overseas markets to change relative to output destined for the domestic market; and they had been asked how they expected the rate of technological or product innovation over the next three years to compare with the rate of innovation in the period 1998-2001.

A53 Responses had been divided into three turnover classifications, and between manufacturers of computer goods and telecommunications products. 57% of respondents had expected output by their UK plants to rise over the next 12 months; 18% expected it to fall. No respondents from the computer sector had expected output to fall significantly, whereas 8% of telecommunications respondents had expected a significant fall in their output. Across the whole sample, companies with turnover of below £500 million had been more confident about prospects for growth in their output over the next 12 months than larger firms. When weighted according to turnover, however, a balance of respondents had expected their output to fall over the next twelve months. Nearly half of the respondents who produced for export had expected output for overseas markets to rise faster than output for the domestic market. In terms of the pace of technological or product innovation over the next three years, almost one third of respondents had expected the rate of innovation to be unchanged from that in the

last three years. Of the remaining firms, the majority had expected the rate of innovation in the next three years to be faster than in the last three.

## **VII Market intelligence**

A54 Between 6 March and 3 April, interest rates implied by short sterling futures contracts had increased. Rates implied by the contract for June 2002 had risen by 5 basis points, and those implied by the contract for March 2003 had risen by 11 basis points, to 5.63%. Chairman Greenspan's testimony and Halifax house price data on 7 March had led to an increase in implied rates at the start of the period. This was later partly offset, mainly following weaker-than-expected RPIX data. Implied rates had subsequently risen again, mainly following stronger-than-expected retail sales data. The difference in implied short-term interest rates between contracts expiring in March 2003 and June 2002 had widened to 116 basis points on 3 April, from 110 basis points on 6 March.

A55 Market participants had generally expected the Committee not to change the Bank's official repo rate in April. Similarly, economists polled by Reuters between 26 and 28 March had attached a mean probability of 81% to the Committee leaving the repo rate unchanged. The majority of traders had expected a repo rate of 4.5% or above by December 2002.

A56 There had been relatively little change in most of the major exchange rates between the Committee's previous meeting and 3 April. In effective terms, the dollar and the euro had both risen by 0.2%. Sterling had risen by 0.6% in effective terms; it had appreciated by 0.4% against the euro and by 1.1% against the dollar. The Japanese Yen had moved within the widest range and had depreciated by 1.3% against the dollar and by 2.0% against the euro. The relative movements in exchange rates had also been reflected in implied volatilities (derived from option contracts), which had remained at or close to historic lows for all the major exchange rates.