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# MINUTES OF MONETARY POLICY COMMITTEE MEETING

## 6 and 7 March 2002

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These are the minutes of the Monetary Policy Committee meeting held on 6 and 7 March 2002

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0203.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 3 and 4 April will be published on 17 April 2002.



## MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 6-7 MARCH 2002

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

### **The world economy**

2 Economic prospects for 2002 had continued to improve in the United States. GDP growth in 2001 Q4 had been revised up from 0.1% over the previous quarter to 0.3%. The central tendency of the forecast of Federal Reserve Governors and Reserve Bank Presidents was for growth of 2½% - 3% between 2001 Q4 and 2002 Q4, which was somewhat higher than the MPC's own projection at the time of the February *Inflation Report*. The Consensus forecast for 2002 had risen. The latest survey indices from the Institute for Supply Management (ISM) had increased in February, from 49.9 to 54.7 in manufacturing and from 49.6 to 58.7 in non-manufacturing. The new orders component of the manufacturing index was over 60, suggesting that strong growth of production was in prospect. Shipments of capital goods in January had been significantly higher than on average in 2001 Q4. This evidence suggested that excess capacity would inhibit investment less than it had over the past year. Initial jobless claims were lower. Productivity had been growing very strongly at the end of last year, and this would help to restrain inflation. Against this positive evidence, it was noted that both the Conference Board and the Michigan surveys of consumer confidence had fallen a little in February.

3 While prospects for 2002 were stronger, the longer-term picture was less clear. It was possible that the speed of the incipient recovery could reflect a bounceback from the rapid destocking which took place in 2001, and from the temporary effect of the terrorist attacks in September, rather than a return to a sustained long-run growth path. Going further forward, uncertainties remained, with persistent imbalances between domestic and traded sectors. The current account was in substantial deficit, and the household debt servicing burden had risen to an historically high level despite low interest rates. It was too early to assess the likely macroeconomic impact of the recent announcement of increased tariffs on some imported steel. It was encouraging that there did not appear to have been any general effect on business confidence from the Enron affair; but equity prices still implied a long-term rate of earnings growth that seemed implausibly high. Moreover, US

reports suggested that in the first three quarters of 2001, the companies comprising the NASDAQ 100 had on average announced far higher “pro forma” earnings than those which they subsequently reported to the Securities and Exchange Commission following US Generally Accepted Accounting Principles.

4 In the euro area, the recent economic data had been weak, but forward-looking indicators were somewhat stronger. No estimate for euro-area GDP in 2001 Q4 was yet available. German GDP had fallen in both 2001 Q3 and Q4, having been unchanged in 2001 Q2, and French GDP had also fallen in Q4. However, the German IFO index had risen in February, its fourth consecutive increase; and the euro-area purchasing managers’ indices had also risen in February for both manufacturing and services. Euro-area consumer confidence had risen from –11 to –9 in February, the highest level since last September.

5 The economic data for Japan were discouraging. GDP had fallen in the second and third quarters of last year, and consumption continued to be weak. It was not clear what effects the government’s recently-announced package to combat deflation would have. However, equity prices had increased over the past month by much more in Japan than in other major markets: the Nikkei index had risen by 7% in the week before the MPC meeting and by 21% since the previous meeting, while in the United States the S&P 500 and the Wilshire indices were up around 7% on the month, and the FTSE All-Share was up only some 3½% in the same period. Japanese corporations were likely to have benefited from the evidence of recovery in the United States and in other Asian countries, and it was likely that the recent weakness of the yen had supported the profitability of Japanese companies. But it was also possible that the performance of Japanese equities had been influenced, at least temporarily, by the imminent end of the financial year, for which date accounts would be reported on the basis of marked-to-market value, and reinforced by the new limitations on short-selling, so it would be difficult to interpret the rise in equity prices for at least another month.

6 Strong economic data in some other Asian countries were consistent with the view that the worldwide information and communications technology sector (ICT) was beginning to turn round. Industrial production in January in both Korea and Taiwan had been over 10% higher than a year before, and exports were growing. Some of the Latin American economies were also picking up.

7 Overall, therefore, the recovery in the global economy appeared to be occurring earlier, and to be faster and more broadly-based, than envisaged the previous month.

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

8 Short-term UK market interest rates had risen, by some 15 to 20 basis points at a one-year maturity, since the Committee's previous meeting. The latest Reuters' survey of economists indicated a virtually unanimous expectation that there would be no change in rates this month.

9 Sterling's effective exchange rate had fallen by 0.2%. There had been a rise of 0.5% against the dollar, and falls of 0.1% against the euro and 1.5% against the yen.

10 The Consensus survey of longer-term expectations for sterling published in February had shown a rise of over 8% in the effective rate expected for 2007 compared with the survey published last October. In consequence, the market now expected only a modest fall in the effective exchange rate over the next five years. The Committee considered why survey respondents had taken the view that the current value of sterling might be broadly sustainable. First, it was possible that the market had finally come to the view that sterling would continue to be strong given that it had been around the current level for over five years. However, it was not clear why expectations had shifted so markedly over the past four months. Second, it was possible that market participants now considered it less likely that if sterling were to enter EMU then it would be at a lower rate against the euro. However, since speculation about EMU entry had in the past often been associated with temporary sterling weakness, it was not clear what could have prompted such a change in view. Third, and supported by some anecdotal evidence, market participants might be giving weight to the fact that the bilateral current account deficit of the United Kingdom vis-a-vis the euro-area countries had not widened since 1996, as might have been expected if sterling had become substantially overvalued against the euro. However, Eurostat data had suggested that the UK current account deficit with euro-area countries had in fact widened over this period, although it was notable that there was a similar discrepancy between the national and Eurostat data for Germany and France. The Committee also considered other evidence relevant to the level of sterling. In particular, the rate of return on capital in manufacturing had fallen substantially in recent years, although this may have been less true in relation to the rate of return in tradable services. While the fall in manufacturing profitability may have resulted from factors additional to sterling's appreciation, it was hard to think

that it was unrelated to it.

11 The annual growth rate of broad money had eased from around 8% in November to 6% in January. However, this was accounted for by the recent decline in deposits held by non-bank financial corporations. These deposits were volatile and often difficult to explain. Excluding this component, broad money had continued to grow at an annual rate of around 8%.

12 Non-financial corporations had increased their holdings of deposits significantly in recent months, and the annual growth rate of this component had increased from less than 3% in the third quarter to over 8% in January. The rise was broadly based across the main subsectors. It was possible that this had reflected corporate decisions to defer investment in 2001 Q4, perhaps reflecting increased uncertainty following the events of 11 September. Lending to manufacturers by the major British banking groups had risen in January and the annual growth rate, although still negative, had risen.

13 Household deposit growth was unchanged in January at just under 8%. Total household borrowing growth had increased again, and the annual rate was now over 11%; both secured and unsecured borrowing growth had continued to rise. The Committee considered the significance of these high rates of growth. The velocity of M4 had been on a declining trend for over twenty years, so it was to be expected that deposit growth would exceed nominal GDP growth. Mortgage equity withdrawal had been exceptionally strong in the second half of 2001, although not all of the proceeds would necessarily be spent immediately. Despite the strong growth in household deposits and borrowing over the past year, the saving ratio had not changed much.

14 The housing market remained strong. Both the Halifax and the Nationwide house price indices had increased by around 15% in the year to February, and the Royal Institution of Chartered Surveyors' survey for January had shown a large increase in the net balance of estate agents reporting house price rises in the last three months.

## **Demand and Output**

15 Although the ONS estimate for GDP growth in 2001 Q4 had been revised down to 0.0%, this was only slightly below the projection included in the February *Inflation Report*, and it was possible

that the estimate might later be revised upwards, given, in particular, more recent data on construction activity.

16 Revisions to the components of expenditure suggested that investment had been weaker than previously estimated in 2001 Q4, while consumption had been much stronger, rising by 1.1% over the third quarter against a previous estimate of 0.7%.

17 Although household borrowing and house prices had continued to rise, which might be expected to support consumption, the latest information was mixed. The volume of retail sales was estimated to have fallen by 0.3% in January and by 0.5% in December. However, these movements were small relative to the size of the statistical seasonal adjustment in both months, so data for at least another month would be required to confirm the trend. The CBI Distributive Trades survey had shown falls in January and February from a very strong December level. It was possible that the unexpected strength of consumer demand before Christmas had meant that the stock of goods remaining to be sold at a discount in January had been lower than usual. This would also be consistent with prices for some consumer goods in January having been discounted less than a year ago. Private car sales had grown robustly taking January and February data together. Looking ahead, consumer confidence surveys remained buoyant. One interpretation of the continuing unexpected strength of consumption in 2001 Q4 was that the effect of interest rate reductions in reducing households' interest payments and facilitating further borrowing had been underestimated. It was possible that some consumers believed that they could afford to devote a given proportion of their income to debt servicing, so that lower interest rates had encouraged them to increase their borrowing, and that this adjustment was still in progress. In that case, any slowdown in consumption in response to a decline in the growth of disposable income might only be gradual while interest rates remained low.

18 Prospects for business activity and investment had improved in the latest month. The CIPS PMI survey for manufacturing was over 50 for the first time in a year, and expectations for output, new orders and export orders were all up. The balance of respondents in the CBI manufacturing survey expecting output to rise in the next three months had risen from -28 in December to +1 in January. The Bank's regional Agents had reported a widespread intention among non-manufacturing contacts to increase investment in 2002, though manufacturers were expected to reduce investment on average.

## **The labour market**

19 There had been continued divergence between employment, which on the Labour Force Survey measure had risen by 0.3% in the three months to December, and average hours worked, which had fallen by 0.7% in the same period. Overtime hours had fallen. The central projection in the February *Inflation Report* had envisaged a rise in unemployment with average hours little changed, and it was possible that recent outturns, which combined lower hours with lower unemployment, would be more supportive of consumption than had been assumed in the central projection.

20 Average annual earnings growth had fallen sharply, to 2.0% in the three months to December, compared with 3.7% in the three months to November. The slowdown was almost entirely accounted for by lower bonuses, and was broadly in line with the Committee's expectations. Weak bonus growth during the period when most bonuses were paid was likely to help slow consumption growth and hence reduce inflationary pressure. Growth in regular pay had fallen slightly, to 4½%, partly reflecting lower overtime payments. There was some evidence that settlements had also moderated slightly in recent months. This easing in pay pressures was perhaps surprising given a rise in the reported willingness of some groups of workers to take industrial action, but the numbers of days lost through strikes remained very low and concentrated in a few industries, mainly those which had previously been publicly owned.

## **Prices and costs**

21 Oil prices had risen by some \$3 per barrel since the previous meeting. The increase partly reflected market speculation that Russia would cut its output in Q2, and also tension regarding Iraq. Other commodity price indices had risen slightly on the month, which would be consistent with some recovery in global economic prospects, but commodity prices remained much lower than a year ago. Global inflationary pressures had in general remained benign, although retail prices had jumped in Europe reflecting a rise in seasonal food prices.

22 The annual rate of RPIX inflation had risen from 1.9% to 2.6% in January, the largest rise in one month for over ten years. The Committee's discussion focused on the implications of this rise for the medium-term prospects for inflation. About half of the rise had been expected, reflecting a rise in petrol prices on the same month a year ago and higher utilities prices. The additional,

unexpected increase reflected several factors: higher seasonal food prices associated in particular with bad weather in Europe; clothing and footwear, where there had been less aggressive discounting in the January sales than in 2001; leisure services, where there had been a sharp rise in annual subscription charges for various television services; and housing depreciation. The rise in TV charges was likely to be locked in for the year, but the other influences were expected largely to unwind over the next few months so that the upward revision to the Bank's inflation projections resulting from these RPIX data would be relatively small. There had, however, been rises in some other measures of UK inflation: housing-adjusted retail prices (HARP), a measure of retail prices adjusted to reflect the Bank's estimate of the user cost of housing, and tax and housing-adjusted retail prices (THARP), which excludes indirect taxes from the HARP index, were both rising strongly. Various measures of domestically generated inflation had all recorded annual rates of over 3% since mid-2001. But the household consumption deflator was rising at an annual rate of less than 2%, and producer input price inflation was negative. Moreover, several survey indicators of price pressures were still relatively benign.

### **The immediate policy decision**

23 The Committee agreed that prospects for world activity had improved over the past month. The recovery appeared to be coming earlier and more rapidly, and to be more broadly-based among countries and sectors, than previously expected, although with the United States still in the lead. Data for US GDP in 2001 Q4 had been revised up, business surveys were stronger, and there was evidence that the overhang of capacity which had been central to the slowdown in growth last year was less likely to inhibit investment going forward. The downside risks for activity in 2002 had therefore diminished, although longer-term uncertainties remained as a result of the persistent economic imbalances. In the euro area the backward-looking economic data were still weak, but a wide range of forward-looking survey evidence was more encouraging, while the signs of recovery in Asia suggested that the ICT sector, which had been a major source of the shock to the world economy, was turning up. But it was not clear how robust the prospects for the United States would be over a slightly longer horizon, and there was still a risk that the euro area and more particularly Japan would not contribute substantially to the recovery. For some members of the Committee, who had previously envisaged greater downside risks to the world economy than assumed in the February *Inflation Report* fancharts, the improvement in prospects was significant: it appeared that the US pick-up was based on more than an end to destocking, and the possible risk to equity markets from

possible future changes in accounting practices had not crystallised as yet.

24 The balance of evidence also suggested stronger economic prospects in the UK. While GDP growth had been revised down in 2001 Q4, the revisions to data on the mix of activity suggested greater strength in consumption and house prices continued to grow rapidly. But there were also downside risks to the outlook for consumption. Two consecutive monthly falls in retail sales might suggest some easing in the pace of growth, although some components of consumption outside retail sales, such as sales of cars, had remained robust. The level of household indebtedness implied the possibility of a sharper adjustment to consumption at some stage. In contrast, while the level of investment in 2001 Q4 had been lower than previously believed, survey evidence, reinforced by reports from the Bank's regional Agents and a turnaround in the rate of decline in production of investment goods, pointed to stronger investment growth going forward. Members agreed that many of the factors contributing to the unexpectedly sharp increase in RPIX inflation in January were likely to prove temporary, so that the lasting effect on the outlook for inflation was only modest. There were some other upward influences on inflation: the price of oil had risen, and measures of domestically generated inflation were running at over 3%. Moreover, if there were more inflationary pressure in the world economy, that could imply an upward influence on UK inflation, though global excess capacity probably implied that these pressures would be subdued for some time. Earnings growth remained moderate, and input prices were also benign.

25 Overall, the balance of evidence on the month pointed to somewhat stronger prospects for UK activity, and it was likely that this would imply a higher path for inflation than had been envisaged in February. However, it was too early to be sure how large and persistent the change in prospects would be and inflation was likely to be marginally below the target of 2½% for some time. It was therefore appropriate to wait for further evidence to assess the change to inflationary prospects. The Committee was clear that interest rates should not be changed this month. But it would be important to monitor closely how the outlook for inflation evolved month to month, and the Committee stood ready to adjust interest rates in either direction as necessary.

26 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.

27 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 1 March 2002, in advance of its meeting on 6–7 March. 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 GDP growth in the United States had been revised up to 0.3% in Q4 in the preliminary release, from 0.1% in the advance release. The upward revision to GDP had reflected stronger consumption and government spending as well as weaker imports. Retail sales had fallen by 0.2% on a month earlier in January, reflecting falling automobile sales. This compared with an upwardly revised 0.2% increase in December.

A3 The Conference Board measure of consumer confidence had fallen to 94.1 in February, from an upwardly revised 97.8 in January. The University of Michigan measure of consumer confidence had also fallen, to 90.7 in February from 93.0 in January. Both declines had been attributable mostly to a sharp fall in the expectations component of the indices. The Institute for Supply Management's (ISM) purchasing managers' index (PMI) for manufacturing had risen to 54.7 in February from 49.9 in January, the highest level since April 2000. The business activity index for the non-manufacturing ISM survey had risen to 58.7 in February, from 49.6 in January. The four-week moving average of initial unemployment insurance claims had continued to decline in February.

A4 Industrial production in the United States had fallen by 0.1% in January, following a 0.3% fall in December. Manufacturing output had been flat in January, the first time it had not fallen since July. Motor vehicle output had declined by 1.2% in January, after strong growth in the previous two months. US non-farm business sector productivity had increased by 0.9% in 2001 Q4. This had reflected the sharp decline in hours worked, which had also reduced household incomes.

A5 German GDP had fallen by 0.3% in 2001 Q4, following a fall of 0.2% in Q3. Inventory adjustment had made a positive contribution to growth, but this had been more than offset by negative contributions from consumption and net trade. Real consumption and real personal

disposable income had fallen by 0.5% and 0.3% respectively in Q4. German retail sales had fallen by a seasonally adjusted 4.1% in December compared with a month earlier. French GDP had declined by 0.1% in 2001 Q4 compared with the previous quarter, following growth of 0.2% in Q3. Positive contributions to growth from consumption and net trade in Q4 had been more than offset by a negative contribution from inventory adjustment. French consumer spending on manufactured goods had fallen by 0.4% in January compared with a month earlier, following an increase of 0.3% in December.

A6 Euro-area industrial production had increased by 0.8% in December compared with a month earlier. The euro-area PMI for manufacturing had risen to 48.6 in February, from 46.3 in January. The euro-area service sector PMI had risen to 51.5 in February, from 51.0 in January. In Germany, manufacturing orders had risen by 5.0% in December compared with a month earlier, following an increase of 0.7% in November. The confidence indicator in the European Commission business survey had remained unchanged at -14 in February. The confidence indicator in the consumer survey had increased to -9 in February from -11 in January. The west German IFO business confidence index had increased to 88.7 in February, from 86.2 in January. The increase had been attributable to a rise in the expectations component of the index. In France, the manufacturing confidence index had risen to 92.0 in February, from 91.0 in January. The German unemployment rate had remained unchanged in February at 9.6%.

A7 In Japan, industrial production had fallen by 1.0% in January compared with a month earlier, following an increase of 1.5% in December. Inventories had fallen by 1.1% on the month in January. The all-industry activity index had fallen by 0.7% in Q4 compared with a fall of 1.7% in Q3. Export volumes had fallen by 1.9% in the year to January compared with a 14.9% decline in the year to December.

A8 The spot price for Brent crude oil had risen to about \$22 per barrel, an increase of around \$2.50 from the price at the time of the Committee's previous meeting. The one-month futures price for Brent crude oil had risen to over \$22.50 per barrel, an increase of around \$3.50 over the same period. The *Economist* all-items commodity price index had risen by 1% since the Committee's previous meeting, while the industrial metals sub-index had risen by 2% over the same period.

A9 In the United States, producer prices had fallen by 2.8% in the year to January, the largest decline since 1950. Core producer prices (which exclude energy and food prices) had increased by 0.3% in the year to January compared with an increase of 0.7% in December. Consumer prices had increased by 1.1% in the year to January, following an increase of 1.6% in December. Core consumer prices (which exclude energy and food prices) had increased by 2.6% in the year to January compared with an increase of 2.7% in December.

A10 Euro-area producer prices had fallen by 0.9% in the year to January, compared with a 1.1% fall in the year to December. The euro-area harmonised index of consumer prices (HICP) had risen by 2.7% in the year to January, up from 2.1% in December and up from the preliminary January estimate of 2.5%. The preliminary estimate for annual euro-area HICP inflation in February had been 2.5%. Core consumer price inflation had increased to 2.4% in January, compared with 2.3% in December.

A11 Equity indices had increased in the United States (the Wilshire 5000 had risen by 7.2%), the euro area (the Dow Jones Euro Stoxx index had risen by 7.2%) and Japan (the Topix had risen by 16.4% and the Nikkei by 20.6%) since the Committee's previous meeting.

## **II Monetary and financial conditions**

A12 The twelve-month growth rate of notes and coin had fallen to 7.6% in February from 8.1% in January. The three-month annualised growth rate had fallen to 8.2% in February from 10.2% in January. The twelve-month growth rate of M4 had fallen to 6.0% in January, compared with 6.6% in December. The twelve-month growth rate of M4 lending (excluding the effects of securitisations) had risen to 9.2% in January from 8.9% in December.

A13 The twelve-month growth rate of households' M4 had remained unchanged at 7.8% in January. The twelve-month growth rate of households' M4 lending (excluding the effects of securitisations) had continued to rise in January, to 11.2%, the highest growth rate since 1990 Q4.

A14 Within total lending to individuals, the annual growth rate of secured lending had risen slightly to 10.3% in January. The number of loan approvals for house purchase had risen, and the annual growth rate of unsecured lending had risen to 14.3% in January.

A15 The twelve-month growth rate of private non-financial corporations' (PNFCs') M4 deposits had risen to 8.3% in January from 6.0% in December. The twelve-month growth rate of PNFCs' M4 lending (excluding the effects of securitisations) had fallen to 7.3% from 8.4% in December. PNFCs had raised £4.4 billion of total external finance in January, compared with an average monthly flow of £3.3 billion in 2001 Q4, predominantly from financial markets. Corporates' net recourse, which is the flow of their M4 lending (excluding the effects of securitisations) less the flow of their M4 deposits, was negative in January, at -£2.3 billion.

A16 The twelve-month growth rate of other financial corporations' (OFCs') M4 deposits had fallen sharply to 0.0% in January. The twelve-month growth rate of OFCs' M4 lending (excluding the effects of securitisations) had risen to 6.1% in January from 4.4% in December.

A17 Short-term nominal rates had risen by 15–20 basis points since the Committee's previous meeting. Long-term nominal forward rates had risen over the month by around 35 basis points at ten years. Much of this rise was accounted for by real rates (derived from index-linked gilts), which had risen by around 20 basis points at ten years.

A18 Inflation expectations derived from gilts at maturities beyond two years had risen by 15–20 basis points since the Committee's previous meeting. Inflation expectations of participants in the HMT monthly survey for 2002 Q4 had remained unchanged at 2.1%, but had fallen slightly, to 2.3% from 2.4%, for 2003 Q4. The Bank's survey of public expectations for inflation had risen in February, but remained well below target. Unlike the HMT survey, the Bank's survey was taken after the RPI data release (12 February).

A19 The standard variable rate (SVR) for mortgages had remained unchanged in February. The two-year discounted rate had risen by 6 basis points. The two-year fixed mortgage rate had risen by 5 basis points. The average quoted overdraft rate had fallen by 130 basis points in February.

A20 The Merrill Lynch aggregate index of investment-grade sterling corporate bond spreads had been little changed since the Committee's previous meeting, although the spread for the telecoms sub-index had fallen. Issuance of non-gilt sterling bonds in February had remained moderate and skewed towards long bonds. Retail lending rates to PNFCs had continued to fall in January.

A21 Most UK equity indices had risen somewhat since the Committee's previous meeting, although the information technology (IT) sector had fallen a little. The number of profit warnings issued in February had been similar to the same month in the previous year.

A22 Since 6 February, the sterling exchange rate index (ERI) had fallen by 0.2% to 106.6. This reflected a 0.5% appreciation of sterling against the US dollar and a 0.1% depreciation of sterling against the euro. Movements in sterling against the dollar and euro had been broadly consistent with relative changes in short-term interest rates. The Consensus Economics survey published in February of longer-term expectations for sterling had shown a rise of over 8% in the effective rate expected for 2007 compared with the survey published in the previous October.

### **III Demand and output**

A23 In the second GDP release, quarterly real GDP growth at market prices had been revised down to 0.0% in 2001 Q4, from the preliminary estimate of 0.2% growth. The revised quarterly rate had been the lowest since 1992 Q2. Annual growth had been revised down to 1.7% from 1.9%. GDP excluding the primary sectors (agriculture, mining and utilities) had risen by 0.2% in Q4 compared with Q3.

A24 Service sector quarterly output growth in Q4 had been revised down to 0.7%, from the preliminary estimate of 0.9%. Within services, growth had been 0.4% in the distribution, hotels and catering sector; 1.2% in the business services and finance sector; and 0.3% in the transport and communications sector. Manufacturing output had fallen by 1.7% in Q4 compared with Q3.

A25 On the expenditure measure, final domestic demand had risen by 0.4% in Q4. Domestic demand had increased by 0.5%. The contribution to GDP growth from stockbuilding in Q4 had been 0.1 percentage points.

A26 Private sector consumption (including that of non-profit institutions serving households) had increased by 1.1%, and real government consumption had risen by 0.2%, in Q4. Whole-economy investment (including the net acquisition of valuables) had fallen by 1.8%. This had been more than accounted for by a fall of 3.2% in business investment, within which private sector services investment had fallen by 5.1% but private manufacturing investment had risen by 2.6%. Net trade

had reduced GDP growth by 0.5% in Q4. Total exports of goods and services had fallen by 1.8%, and imports had fallen by 0.2%.

A27 Turning to 2002 Q1, retail sales volumes had fallen by 0.3% in January, following a 0.5% fall in December. In the three months to January 2002, growth had eased to 0.9%, compared with growth of 1.3% in the three months to December 2001. But the Confederation of British Industry (CBI) Distributive Trades survey had suggested that growth in retail sales volumes would increase in the coming months. The expected sales balance had risen to +38, although the reported sales balance had eased slightly to +33. Consumer confidence was broadly unchanged in February. The GfK index had been +5 in February, compared with +6 in January. The MORI measure of consumer confidence had fallen to -21 from -20 over the same period.

A28 The Nationwide house price index had risen by 1.6% in February, taking the annual growth rate to 14.0%. The Halifax house price index had increased by 1.5%, taking its annual growth rate to 16.9%. Preliminary figures for The Royal Institution of Chartered Surveyors' (RICS) balance of estate agents reporting increased prices over the previous three months had increased to +49 in February from +47 in January. Particulars delivered had fallen by 3,000 in January, to 121,000. But transactions in the three months to January had been 0.8% higher than in the three months to October, and 1.3% higher than in the same period a year earlier.

A29 The Chartered Institute of Purchasing and Supply (CIPS) manufacturing activity index had been 53.5 in February, the first value above the no-change level of 50 for a year. The orders index had also picked up, to 53.4, the highest level for a year. The CBI manufacturing Monthly Trends survey had also suggested some improvement in February — the expected output index rose to +1 from -13 in January.

A30 The CIPS service sector survey had reported a further improvement in service sector activity in February. The activity index had risen to 52.1, from 51.4 in January. The CBI/ Deloitte & Touche service sector survey had also suggested a slight improvement in prospects for the service sector.

#### **IV Labour market**

A31 According to the Labour Force Survey (LFS), employment had increased by 80,000 in the fourth quarter, compared with the previous quarter. Female employment had risen by 58,000, while male employment had risen by 22,000. The working-age employment rate had increased by 0.1 percentage points to 74.6%, and had been largely unchanged since July 2001. Although the number of people employed had risen, total hours worked had fallen by 0.5% to 32.6 hours per week in the fourth quarter, reflecting a 0.7% fall in average hours.

A32 The CIPS employment survey for February had suggested a largely unchanged employment picture. The manufacturing index had been unchanged but the construction and services indices had both ticked up slightly, although only the construction employment balance was positive. The CBI service sector survey had shown a rise in employment expectations. It had also shown a sharp rise in consumer services labour shortages, although the survey had revealed little change in shortages in business and professional services.

A33 The LFS measure of unemployment had risen by 34,000 in the fourth quarter, compared with the previous quarter. The rate had risen by 0.1 percentage points to 5.2%. Over the same period, claimant-count unemployment had risen by 10,300, but it had fallen by 10,600 in January. Inflows into the claimant count had fallen for the second consecutive month.

A34 Inactivity among those 16 and older had fallen by 56,000 in the fourth quarter and the rate had fallen by 0.2 percentage points to 36.6%. Female inactivity had declined by 57,000.

A35 Headline (three-month average basis) whole-economy annual earnings growth, as measured by the Average Earnings Index (AEI), had declined by 0.8 percentage points to 3.3% in December. Headline annual earnings growth in the private sector had been fallen by 0.9 percentage points to 2.9%, while headline earnings growth in the public sector had fallen by 0.2 percentage points to 5.2%. Actual whole-economy earnings growth had been 2.0% in the year to December, compared with 3.7% in November. This had been the lowest figure for actual whole-economy earnings growth since 1967.

A36 The decline in average earnings growth had reflected a sharp reduction in bonuses in December, a month in which bonuses account for a larger-than-usual fraction of aggregate earnings. Whole-economy regular pay growth (not seasonally adjusted) had declined by only 0.1 percentage points to 4.5% in the year to December. Bonuses had contributed -2.6 percentage points to earnings growth. There had been reports of substantial falls in financial sector bonuses, but bonuses had also made a large negative contribution in manufacturing.

A37 According to the Bank's settlements database, the twelve-month AEI-weighted mean settlement had ticked up slightly to 3.4% in January. However, a comparison of those settlements in January that could be matched with the same firms' settlements in 2001 had suggested a slight moderation on a year ago. The Bank had so far received information on 196 agreements effective in January, covering 117,000 employees. This had been only about 10% of the normal January figure for employees covered by January settlements.

A38 Annual growth in productivity, on the Bank's early estimate, based on LFS employment and GDP at basic prices, had declined by 0.7 percentage points to 0.7% in Q4. On a total hours basis, productivity had increased by 1.5% per hour on a year earlier. Manufacturing productivity had declined by 1.8% in the year to December. The Bank's early estimate of annual growth in unit wage costs had fallen to 2.6% in Q4.

## **V Prices**

A39 The Bank's sterling commodity price index had risen by 0.8% in January, the second consecutive monthly increase. Increases on the month in the prices of oil and metals, of 4.8% and 3.7% respectively, had outweighed a fall of 0.4% in domestic food prices. Due to base effects, the annual inflation rate of the index had fallen slightly to -5.2% in January, from -5.0% in December.

A40 There had been further moderate rises in oil prices in February. But oil prices were around 25% lower than a year earlier.

A41 Manufacturing input prices had risen by 0.6% in January. This had mainly reflected increases in the prices of crude petroleum products and imported metals. Annual input price inflation had been unchanged in January at -6.2%. The CIPS manufacturing survey had suggested that input price

pressures would continue to be weak going forward. The input price balance had remained below the no-change level of 50 for the tenth consecutive month, although it had risen slightly to 39.8 in February, from 39.3 in January.

A42 Manufacturing output prices excluding duties (PPIY) had risen by 0.2% in January, while the annual inflation rate had risen by 0.5 percentage points to 0.1%. Survey data had continued to point to subdued output price inflation going forward. The CBI Monthly Trends survey expected output price balance had risen moderately to -20 in February, from -23 in January.

A43 The ONS's experimental corporate services price index (CSPI) and the CIPS services survey had both suggested that service sector inflation had eased. The CSPI annual inflation rate had fallen to 3.9% in 2001 Q4, from 4.4% in the previous quarter, and the CIPS services survey average prices charged index had fallen to 50.1 in February, from 51.1 in January.

A44 The annual inflation rate of the GDP deflator had risen to 2.8% in 2001 Q4 from 2.4% in Q3. Within this, the annual inflation rates of the household consumption and the government deflators had fallen to 1.6% and 3.5% respectively in Q4. The annual inflation rate of the import price deflator had fallen further to -2.8% in Q4, from -0.2% in Q3.

A45 Annual RPIX inflation had risen sharply in January to 2.6% from 1.9% in December. The rise had been broadly based: annual services price inflation had risen by 0.5 percentage points in January to 4.6% and annual goods price inflation had risen to 0.5% from -0.3% in December. On the RPI measure, annual inflation had risen by 0.6 percentage points to 1.3% in January. Annual RPIY inflation had risen to 3.0%, while annual HICP inflation had risen to 1.6%, up from 1.0% in December.

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

A46 The Bank's regional Agents had reported that the decline in manufacturing output had levelled out in most regions. Confidence among manufacturing contacts had generally improved but the expected timing of a return to growth in output had remained uncertain. On the positive side, the US export market had appeared to be improving and the domestic information and communications technology (ICT) sector had increased capacity utilisation, albeit from a very low level. However,

expectations for aerospace had probably deteriorated in the short term. Some manufacturers had reported a second round of cuts in orders by civilian airlines, while military orders for new aircraft had not yet resulted in increased output. The main factor limiting the upturn in manufacturing output had been the persistent migration of capacity out of the United Kingdom to lower cost centres.

A47 Activity in professional services had been steady or improving. Insolvency work, IT consultancy, auditing, and consulting on new regulations had all been areas of growth. Business travel had also bounced back after a post-11 September decline. However, firms increasingly had been using budget airlines and hotels. Distribution services had reported declining requirements to transport components for manufacturers but strong demand from retail clients. Retailers themselves had reported strong sales value growth in contrast to slightly weaker official sales data. Agents had reported strong sales across a wide range of goods, and rapid growth in personal borrowing. January and February had been strong months for new car sales, although contacts had expected that the exceptionally high growth of sales in 2001 would not persist in 2002.

A48 In the labour market, manufacturing job losses had continued and were no longer being offset by gains in other sectors. In the service sector there had been some job cuts, for example in investment banking, and widespread freezes on recruitment. At the same time, however, job creation in areas such as retail and transport had continued. Skill shortages had persisted for construction workers and drivers, and also for unskilled jobs in particular localities. Private sector pay settlements had been lower year-on-year, although few settlements had been below 2%. Pay freezes had been more common. Total employment cost trends had been less subdued due to increased costs of funding pension schemes, paternity leave, litigation and the Working Time Directive.

A49 The decline in material input prices had begun to slow, and volume discounts were not available to manufacturers who had reduced output. Overheads, such as rent, regulation, insurance and tax had continued to rise. Price inflation in consumer services, such as hairdressing, had been stronger than in retail goods.

A50 The Bank's regional Agents had conducted a special survey of around 225 firms. Respondents had been asked to compare their firm's current level of physical capacity with its desired level, and to compare planned investment for 2002 with actual investment in 2001.

A51 Most firms outside manufacturing had felt they were below their desired level of physical capacity, and planned to invest more in 2002 than in 2001. For many service sector firms, the planned rise in investment expenditure had reflected increased replacement investment and an expected improvement in demand conditions. But a majority of respondents in the manufacturing sector planned to reduce investment, citing adverse demand and profit prospects.

## **VII Market intelligence**

A52 Between 6 February and 6 March, implied rates for short sterling futures had risen. Rates implied by the contract for June 2002 had risen by 11 basis points, and those implied by the contract for December 2002 had risen by 19 basis points. Stronger-than-expected RPIX data had led to a rise in short-term interest rate expectations, but this was later partly offset; weaker-than-expected UK retail sales data, official comments and publication of the MPC minutes were the main downward influences on rates. Short-term interest rate expectations had then risen on stronger-than-expected US ISM and UK CIPS manufacturing survey and Nationwide house price data. The difference in short-term interest rates between contracts expiring in December 2002 and June 2002 had widened to 80 basis points on 6 March from 72 basis points on 6 February. Interest rate uncertainty had risen following the release of the RPIX data, but had subsequently fallen.

A53 Market participants had generally expected the Committee not to change the Bank's official repo rate in March. Similarly, economists polled by Reuters on 27 February attached a mean probability of 80% 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.

A54 There had been little change in the major exchange rates over most of the period since the Committee's previous meeting, although the dollar had weakened towards the end of the period. Despite the perception of an improving economic outlook for the United States, the dollar depreciated; this had been ascribed by some in the market to concerns about the valuation of some US companies given US accounting practices. The dollar had weakened by 2% against the yen. Sterling had depreciated slightly, by 0.2% in effective terms. It had fallen by 0.1% against the euro and was 0.5% stronger against the dollar.