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MINUTES OF MONETARY POLICY COMMITTEE MEETING 6 and 7 November 2002

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

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0211.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting held on 4 and 5 December will be published on 18 December 2002.



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

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

The world economy

2 Since the October MPC meeting, equity market indices had risen by around 20% in the United States and the euro area and around 5% in Japan. In the United States, they were now back to levels similar to those in the *August Inflation Report*. Just as the falls in September had been difficult to account for, it was difficult to explain the recent increases in terms of changes in either expected corporate earnings or real interest rates, although, in the previous week or so, a growing expectation in financial markets that the Federal Reserve would reduce interest rates this month had provided some support. One possible explanation was that the risk premium on equities had fallen as a result of reduced uncertainty about stock values. There had, indeed, been some reduction in the expected volatility of equity prices implied by options prices, and the tone of the market seemed to have improved. Whereas, in September, positive news about the US economy appeared to have had relatively little impact on equity markets, financial market pessimism appeared to have diminished in October.

3 World activity had been broadly in line with the Committee's August central projection, with the United States perhaps having been a little stronger than projected and the euro area a little weaker. In the United States, quarterly GDP growth had risen from 0.3% in Q2 to 0.8% in Q3, according to the advance estimate. That had reflected strong consumption growth; investment, in contrast, had been broadly flat. The growth of broad money and of lending to households had supported activity. Mortgage refinancing had been high, encouraged by the drop in US long-term interest rates until early October. The housing market had remained robust. Only lending to commercial and industrial companies had been weak, possibly reflecting both weak investment and a tightening of credit conditions for some corporate borrowers, judging by the rise in corporate credit spreads in Q3. However, there had been some more general signs of renewed weakness in the economy during the

quarter, for instance reflected in the tone of the Federal Reserve's Beige Book. On the output side, industrial production had fallen again in September after contracting in August. On the demand side, retail sales had also dropped in September, reflecting in particular low motor vehicle sales, which suggested that consumption growth might have weakened. Auto sales, boosted by 'zero-interest' finance offers, had helped to sustain demand in Q3, but it was not clear that such offers would continue to be as effective in boosting sales if households had already brought forward their intended vehicle purchases.

4 Data so far for October confirmed the impression that there had been some slowing in the US recovery. The ISM indices for both manufacturing and non-manufacturing had fallen slightly, although the latter remained above the 50 'no-growth' threshold, and unemployment had increased a little. The most striking news had been the sharp fall, one of the biggest in the past ten years, in the Conference Board Index of consumer confidence. Fears about worsening employment prospects may have been responsible: according to the Conference Board survey, the proportion of respondents describing jobs as plentiful fell to its lowest level since 1994, while the proportion describing jobs as hard to find rose to its highest level since then. The Michigan headline measure of consumer confidence had also dropped, although not by as much. It was possible that the falls were partly a reaction to the falls in equity markets in previous months. If so, the recovery in equity prices in October might prompt a recovery in confidence. The falls had, however, been larger than could be accounted for by the factors usually associated with consumer confidence; moreover, such unexplained falls had in the past tended to be correlated with falls in consumption itself. The FOMC's 50 basis-point reduction in interest rates, which took place during the MPC's meeting, should, however, help to offset any temporary weakness in the US economy.

5 Indicators for the euro area had been mixed. It was likely that quarterly GDP growth in Q3 had, as in Q2, been a little below its long-run trend and sustained primarily by external demand. The euro-area Purchasing Managers Indices for both manufacturing and services had risen slightly in October. According to European Commission measures, industrial confidence had increased a little in October too. But consumer confidence had fallen somewhat, despite the recovery in equity markets. According to the IFO Index, German business confidence had continued to decline. But it would be misleading to focus only on Germany. The rest of the euro area was performing rather more strongly.

6 In Japan, industrial production had continued to grow in Q3 and tertiary activity had picked up further in August. That would have helped the emerging market economies of Asia. China's economy

remained robust but there were some signs of growth slackening in Korea, Singapore and the Philippines, probably due to less rapid increases in exports.

Money, credit and asset prices

7 Equity prices in the United Kingdom had increased by about 10% over the past month, and were now back to around the levels of late July. Sterling's effective exchange rate had fallen by around one percentage point over the month, and was also little changed from levels three months ago.

8 Although the twelve-month rate had fallen back a little, the growth rate of broad money (M4) on a three-month annualised basis had picked up since May. Lending by banks and building societies to other financial companies and the household and corporate sectors accelerated in Q3. The growth of total lending to individuals in particular rose further, and the flow of unsecured lending in Q3 had probably risen to its highest rate relative to personal disposable income since the data series started in the mid-1980s.

9 The growth of lending to households seemed likely to remain high for some time. Mortgage arrears were running at low levels and there was little expectation on the part of lenders that either unemployment or interest rates would increase significantly in the near term. The growth in lending secured on property did not simply reflect the fact that households needed to borrow more to be able to afford higher house prices. Households were able to finance consumption relatively cheaply by making use of residential property as collateral and utilising new, more flexible, borrowing products; also, as a result of the increase in house prices, fewer households were credit constrained. Consequently, it was likely that mortgage equity withdrawal had increased further in Q3 relative to personal disposable income. The growth had probably been fuelled partly by falls in the rates of interest charged on mortgages and credit cards relative to the Bank's repo rate, brought about by vigorous competition amongst financial institutions. It was also possible that some house buyers had not fully appreciated the persistence of the real burden of mortgage borrowing implied by the slower fall in the real value of the principal in a world of low inflation.

10 House prices had continued to rise rapidly in October. The monthly rises in the Halifax index in September and October had been the largest ever recorded. Comparing the latest three months with the previous three, the annualised rates of increase on both the Halifax and Nationwide indices were now close to 30%. Over recent months, rates of increase had been particularly high for lower-value

properties and in regions outside the South East; quarterly rates of increase in the South East, however, had in fact fallen. This would narrow the gap between house prices in London and the South East and those in the rest of the country. According to preliminary data from the Royal Institution of Chartered Surveyors (RICS), however, the net balance of estate agents expecting house prices to increase in the next three months rose in October. Also, although particulars delivered fell in September and the RICS reported a fall in the average number of properties sold by estate agents in the past three months, loan approvals rose on the month and the balance of net reservations increased. On this evidence, there was therefore little sign that the house price boom was drawing to an end.

Demand and output

11 GDP at market prices rose 0.7% in Q3, according to the preliminary ONS estimate, a slightly faster rate than in Q2. But, taking Q2 and Q3 together (to abstract from the effects of the Jubilee holiday on the pattern of output and expenditure), growth was close to its long-run trend, although slightly lower than expected at the time of the August projections. Excluding the volatile energy component, GDP growth this year had increased quarter by quarter.

12 Consumption growth appeared to have dipped sharply in Q3, judging by the slowdown in private buyers' car registrations and the fall in the growth rate of retail sales, although the apparent weakness may partly have reflected the impact of the timing of Easter on the Q1 and Q2 data. Information from the Bank's Agents also pointed to some weakening. In October, the GfK survey of consumer confidence had fallen a little but the overall balance was still above the average of recent years. This was consistent with a robust outlook for consumption in Q4, as was the CBI Distributive Trades survey, with the balances for both reported and expected retail sales rising in October to somewhat above the historical average for the series. The prospective slowing in the growth of real personal disposable income and recent falls in household wealth due to lower equity prices were likely to act as a drag on consumption growth next year, but the further recent increases in house price inflation would provide additional scope for mortgage equity withdrawal.

13 Investment, which had edged down in Q2, seemed likely to remain weak in the near term. Surveys of investment intentions had generally softened and, according to the CIPS manufacturing survey, new capital goods orders had been falling. Although investment was likely to pick up at some stage simply because of the need to replace plant and equipment, the timing and strength of any

recovery remained uncertain. Public expenditure, however, was likely to continue to support the growth of demand looking forward.

The labour market

14 According to the latest data, unemployment barely changed in the three months to August, on the LFS measure, or in September, on the claimant count measure. But average hours worked were 1.6% lower in the three months to August than in the previous three months, and there were falls for both men and women, part-timers and full-timers; so labour input in terms of total hours had fallen, even though the number of people employed continued to increase. It was unclear whether this easing was cyclical, or represented a shift in the pattern of labour supply. If it was the former, it seemed larger than past experience would have suggested. There were, however, indications that the decline in average hours had taken place at least in part because workers wanted to work fewer hours: employers did not seem to be rationing the hours of work they offered to a significantly greater degree. If so, total labour supply might now be lower than previously thought. The Working Time Directive could be part of the explanation of the downward trend in hours worked per head, but it seemed unlikely to be the only factor.

15 The headline rate of growth of average earnings was broadly unchanged in August. Earnings growth in the public sector had slowed while in manufacturing it had increased, continuing the pattern of the latest six months or so. It was not clear that this divergence was significant. In part, the slowdown of reported public sector pay reflected delays in local authority pay settlements, which would be backdated when implemented (although the backdating would not be reflected in the average earnings data). It was possible that difficulties in reaching settlements were becoming greater. In the private sector as a whole, pay settlements this year had been running at a rate about half a percentage point lower than in 2001; this may have reflected the particularly low levels of headline inflation in the early part of 2002. Looking forward, the prospective increases in employers' and employees' National Insurance contributions were likely to affect pay bargaining and might be one of the factors behind anecdotal reports that pay negotiations would be more difficult next year.

Prices and costs

16 The twelve-month rate of RPIX inflation rose to 2.1% in September, bringing the average level in Q3 to 2.0%, a little higher than in the Bank's projection at the time of the August *Inflation Report*.

It was likely to continue to increase over the next few months, reflecting two factors which were probably transitory: first, substantial twelve-month increases in the price of oil, due to the temporarily sharply lower oil prices last year in the aftermath of the 11 September terrorist attacks; and second, the direct contribution of the housing depreciation element of RPIX, boosted by the acceleration of house prices over the past year. The sterling price of Brent oil had fallen by about 15% since the previous MPC meeting. Oil futures suggested that market participants had not changed their views much about oil prices in the long term, expecting them to be a little below their current level. It appeared that OPEC nations were still producing oil at a rate above that implied by OPEC's country quotas, which had remained unchanged at the latest review.

The November GDP growth and inflation projections

17 The Committee reached its policy decision in the light of the projections to be published in the *Inflation Report* on Wednesday 13 November.

18 Based on the assumption of an unchanged repo rate of 4% over the next two years, on the central projection, the four-quarter growth rate of GDP would pick up further to a little above its long-run trend by early 2003, before settling around trend thereafter. The twelve-month RPIX inflation rate was likely to move above the 2.5% target by the end of this year, remaining there for much of 2003, reflecting the temporary influences described in paragraph 16 above, before dropping slightly below target and then edging up gradually to around 2.5% by the two-year forecast horizon. RPIX inflation was now likely to be higher over the next year or so than in the August projection, but marginally lower in the following year.

19 There were major risks to the outlook. First, there was a downside risk to world demand. Second, there was a possibility that rapid house price inflation would continue in the short term, raising the likelihood of a sharp correction in the future, generating upside risks to consumption in the near term and downside risks further out. Third, there was also an upside risk to inflation and a downside risk to demand from the prospective increases in National Insurance contributions. As indicated by the *Inflation Report* fan charts, the overall risks to growth were judged to be slightly on the downside relative to the central projection, while the risks to inflation were judged to be marginally on the upside. There were some differences of view among Committee members about the overall balance of risks, but the spread of opinion was relatively narrow.

Other considerations

20 Since August, Consensus forecasts of world economic growth had tended to fall, coming more into line with the Committee's forecasts. The current *Inflation Report* forecast of UK output growth next year was a little above, and its forecast of RPIX inflation was similar to, the average of the forecasts covered by HM Treasury's regular survey. However, comparisons were less helpful than usual because of the recent high volatility of asset prices; the outside forecasts had been finalised at different times and so would have assumed differing initial values for asset prices.

21 The Committee discussed the policy action by the FOMC. It agreed that there was no particular reason, in current circumstances, for policy rates of different countries to change in tandem. The implications for the United Kingdom of moves in policy rates elsewhere depended on the impact of those moves on domestic demand in the countries concerned (and so on UK external demand), on interest rate expectations and on the exchange rate. To the extent that reductions in interest rates elsewhere addressed sources of weakness in external demand for UK output without being offset by yield curve or exchange rate movements, they lessened the need for UK policy further to stimulate domestic demand. It was noted that the FOMC rate reduction had not immediately had a substantial effect either on long-maturity dollar interest rates or on sterling's exchange rate.

The immediate policy decision

22 UK growth had been moving back to close to its long-run trend rate in the past couple of quarters; abstracting from special factors such as the timing of Easter and the Jubilee holiday and the volatility of energy output, underlying growth appeared to have picked up since the turn of the year. RPIX inflation was close to target. Looking forward, the new forecast suggested that, in broad terms, this picture of growth near trend and inflation near target was likely to be sustained. There were, however, substantial uncertainties about growth and inflation in both directions. The most significant risks were associated with international economic prospects and the growth of domestic consumption. The latest economic data had been mixed. On the one hand, the sharp fall in consumer confidence in the United States might be an early indication that US consumption was slowing, and the Q3 outturn for UK GDP had been a little lower than expected earlier in the year. On the other hand, equity price indices in many countries had risen substantially on the month and household borrowing, house prices and some surveys suggested that UK consumption growth would be robust in the near term.

23 The Committee considered what level of interest rates was appropriate in the light of this outlook. A number of arguments suggested that a reduction in interest rates was warranted. First, in the view of some members, the outlook for world demand was somewhat weaker than was reflected in the Committee's *Inflation Report* projections. US prospects were particularly important in this respect. It seemed unlikely that demand in the rest of the world would increase sufficiently rapidly to offset any adverse US developments. If the fall in US consumer confidence signalled the beginning of a longer-term adjustment by households of their financial balance sheets, the US economy would grow more slowly than expected. Greater caution on the part of banks and other lenders about corporate sector credit risk might restrain business investment, and the extent to which the boost to auto sales over the summer had been at the expense of lower sales in the future was not clear. Second, UK consumption growth might slow sooner than forecast. The signs were that consumption growth had been weak in Q3, and it was not yet clear that the expected bounce-back in Q4 would materialise. Third, there was little evidence yet of an investment recovery. Given the signs of weakness in business confidence, UK investment might not recover at the pace assumed in the central projection and so might not contribute as expected to domestic demand as household consumption growth slowed. This risk would be greater, were the sterling exchange rate not to depreciate; it was projected to do so gently. Fourth, it was suggested that it could be particularly important to adjust interest rates pre-emptively when nominal rates were at very low levels, although the argument was less immediately relevant to the United Kingdom than to some other countries. Fifth, although household debt levels might be increased by a rate reduction, magnifying the effect of any subsequent negative demand shock, some members argued that monetary policy could address that problem if and when it arose.

24 There were, however, arguments for maintaining interest rates at their current level which, taken together, most members found more persuasive. First, consumption growth in the United Kingdom was expected to remain buoyant in the near term. Household borrowing, both secured and unsecured, had been remarkably strong, demand for loans was not abating, and there were few signs that lenders were tightening credit conditions for consumers. New lending products and the sharp rises in house prices had allowed more households to use mortgage equity withdrawal to help maintain their consumption in the face of slower growth in disposable income, and the increase in housing wealth might itself tend to stimulate consumption growth. Second, a reduction in interest rates now risked stimulating house prices and household borrowing even further, increasing the risk of a sharper fall in consumption at some point in the future. Third, there were risks to the inflation projection, but they were on both the upside and the downside. The central projection suggested that the current level of

the repo rate was consistent with hitting the inflation target both on average over the next two years and at the end of the forecast horizon. Fourth, the upside risk to costs and prices from the labour market might be greater than the forecast allowed. The fall in hours worked might in part have reflected a reduction in labour supply, there were some signs of greater difficulties in concluding pay settlements, and above-target inflation in the near term might risk greater upward pressure on settlements. Finally, the risks to the inflation forecast posed by the housing market were on the upside in the near term. If any of the downside risks to demand began to crystallise, there would be time to reduce rates to help keep inflation on target around the two-year horizon.

25 The Governor invited members to vote on the proposition that the Bank's repo rate should be maintained at 4.0%. Seven members of the Committee (the Governor, Mervyn King, Andrew Large, Kate Barker, Charles Bean, Marian Bell, and Paul Tucker) voted in favour. Christopher Allsopp and Stephen Nickell voted against, preferring a reduction in the repo rate of 25 basis points.

26 The following members of the Committee were present:

Eddie George, Governor
Mervyn King, Deputy Governor responsible for monetary policy
Andrew Large, Deputy Governor responsible for financial stability
Christopher Allsopp
Kate Barker
Charles Bean
Marian Bell
Stephen Nickell
Paul Tucker

Jon Cunliffe 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 November, in advance of its meeting on 6-7 November. At the start of the Committee meeting itself, members were made aware of information that had subsequently become available, and that information is included in this Annex.

I The international environment

A2 According to the advance estimate, US GDP in 2002 Q3 had grown by 0.8% on a quarter earlier and 3.0% on a year earlier. Consumption had grown by 1.0% on the previous quarter, mainly because of strong auto sales, which had risen by 10.3%. Investment had risen by 0.1% compared with a quarter earlier, but within that, spending on machinery and equipment had grown by 1.6%. Government spending had risen by 0.5% on the quarter. Inventories and net trade had made no contribution to overall quarterly GDP growth in Q3. Manufacturing output had fallen by 0.3% in September compared with August, while production of information, communications and technology goods (ICT) had grown by 1.1% in September. New orders for non-defence capital goods had fallen by 10.6% in September on a month earlier. The Institute for Supply Management (ISM) manufacturing index had fallen to 48.5 in October, from 49.5 in September. The headline business activity index for the ISM non-manufacturing survey had declined to 53.1, from 53.9 in September.

A3 US retail sales (excluding motor vehicles) had risen by 0.1% in value in September on a month earlier, while motor vehicle sales had fallen by 4.8%. The Conference Board measure of US consumer confidence had fallen to 79.4 in October from 93.7 in September. The University of Michigan headline index of consumer confidence for October had fallen to 80.6 on the final measure, compared with 86.1 in September.

A4 Headline consumer price inflation (CPI) in the United States had fallen to 1.5% in the year to September, from 1.8% in the year to August. Core CPI (excluding food and energy) had risen by 2.2% in the year to September, compared with 2.4% in the year to August. US producer prices had fallen by 1.9% in the year to September. The US trade deficit had increased to \$38.5bn in August, from \$35.1bn in July. US non-farm payrolls had fallen by 5,000 in October, following a 13,000 fall in September. The unemployment rate had risen to 5.7% in October, from 5.6% in September. Average hourly earnings had increased by 0.2% in October compared with a month earlier.

A5 Euro-area industrial production had risen by 0.6% in August after decreasing by 0.8% in July. The European Commission measure of business confidence had increased to –10 in October, from –12 in September. The West German IFO index had fallen to 87.7 in October, from 88.2 in September. German manufacturing orders had fallen by 2.5% in September on the previous month, after an increase of 1.4% in August. According to the INSEE survey, business confidence in France had declined to 94 in October, from 97 in September. The euro-area Purchasing Managers' Index (PMI) for manufacturing had risen slightly in October, to 49.1, from 48.9 in September. The services PMI had risen to 50.1, from 49.1.

A6 Euro-area retail sales had increased by 0.8% in August on a month earlier after increasing by 0.9% in July. French consumer expenditure on manufactured goods had fallen by 1.2% in September relative to the previous month. Euro-area unemployment on the seasonally adjusted International Labour Organisation (ILO) measure had remained unchanged at 8.3% in September.

A7 The euro-area harmonised index of consumer inflation (HICP) had increased by 2.1% in the year to September, unchanged from August. Annual core inflation in the euro area had fallen to 2.4% in September, down from 2.5% in August. The flash Eurostat estimate for euro-area HICP inflation had indicated a rate of 2.2% in the year to October. Industrial producer prices had increased by 0.1% in the euro area, in the year to September 2002.

A8 In Japan, industrial production had risen by 2.1% in 2002 Q3 relative to a quarter earlier, compared with 3.8% in 2002 Q2. The index of tertiary activity had risen by 0.5% in August compared with a month earlier, the second consecutive monthly increase. Export volumes had risen by 9.2% and import volumes by 13.1% in the year to September.

A9 Industrial production had shown signs of slowing in some other Asian countries, in particular Korea, Singapore, and the Philippines. The growth of Korean export values had slowed in September. Export values from China and Taiwan had bounced back in September after weakness in August. China's GDP growth had been 8.1% in the four quarters to 2002 Q3.

A10 Since the Committee's previous meeting, the spot price of Brent crude had fallen from \$28 per barrel to around \$24. The *Economist* dollar non-oil commodity price index had risen by 1.6%, with metals prices having risen by 5.0% and food prices by 0.9%. The major international equity indices

had risen since the Committee's October meeting: the Wilshire 5000 by 18.6%, the FTSE All Share by 9.5%, the Dow Jones Euro Stoxx by 19.4% and the Japanese Topix by 4.6%.

II Monetary and financial conditions

A11 The twelve-month growth rate of notes and coin had been 8.3% in October, unchanged from September. The twelve-month growth rate of M4 had fallen to 5.4% in September, from 5.7% in August. But the twelve-month growth rate of M4 lending (excluding the effects of securitisations) had risen markedly, to 9.6% in September from 8.0% in August. Growth in the monetary aggregates excluding other financial corporations (OFCs) had remained steadier.

A12 The twelve-month growth rate of households' M4 had fallen to 8.1% in September, from 8.3% in August. Annual growth in households' Divisia money, which weighted the components of households' M4 by a measure of their liquidity, had also fallen, to 9.3% in Q3 from 9.5% in Q2. The twelve-month growth rate of households' M4 lending (excluding the effects of securitisations) had risen to 13.5% in September, compared with 13.2% in August. The household sector had borrowed substantially more than it had deposited in Q3. Within total net lending to individuals, the annual growth rate of secured lending had continued to rise, by 0.3pp to 12.4% in September, the highest level since 1990 Q4. The twelve-month growth rate of unsecured lending had also increased, to 15.8% in September from 15.6% in August.

A13 Particulars delivered had fallen sharply, to 132,000 in September from 152,000 in August. The number of loan approvals for house purchase had been higher in September, at 117,000, compared with 109,000 in August. But after adjusting for the number of working days, the rise in September had been slightly lower, and Q3 as a whole had been weaker than both Q2 and Q1.

A14 The twelve-month growth rate of private non-financial corporations' (PNFCs') M4 deposits had risen slightly, to 6.1%, in September. Annual growth of PNFCs' M4 lending (excluding the effects of securitisations) had fallen to 3.8% in September, from 4.0% in August.

A15 Within the quarterly industrial breakdown of sterling bank lending, the annual rate of repayment of bank debt by manufacturers had increased in Q3. Annual growth of lending to real estate companies had remained robust.

A16 PNFCs had raised a monthly average of £5.0bn in total external finance in Q3, compared with an average of £3.6bn in the preceding six months. Within this total, capital issuance had remained firm in Q3. The twelve-month growth rate of OFCs' M4 deposits had fallen further, to -1.9% in September from -1.3% in August. The twelve-month growth rate of OFCs' M4 lending (excluding the effects of securitisations) had risen sharply, to 5.3% from -1.1% in August.

A17 Since the Committee's previous meeting, the FTSE All-Share index had risen by 9.5%. While all sectors had risen, the financial and information technology sectors had performed particularly strongly. Equity index uncertainty, as measured by the implied volatility from option prices, had fallen. Institutional Brokers Estimate System earnings forecasts for 2002 had fallen between September and October, but the long-term forecasts were little changed. The number of UK profit warnings issued in October had been lower than in September, and substantially lower than a year ago.

A18 Nominal gilt forward rates had risen at all maturities, by around 25 basis points at the two-year maturity and around 30 basis points at the ten-year maturity. The skew on three-month short sterling interest rates, an indicator of perceptions of the balance of risks, had become more negative. Real forward rates had risen at all maturities, by around 10 basis points at ten years.

A19 Quoted interest rates on household borrowing had been broadly unchanged since the Committee's previous meeting, although there had been a slight increase in the cost of two-year discounted mortgages, of around ten basis points. Two-year fixed mortgage rates had remained stable in October after falling for the past few months.

A20 Implied expected inflation rates derived from conventional and index-linked gilts had risen across the curve, and had increased by around 20 basis points to around 2.6% at the ten-year horizon. Consensus Economics forecasts of average inflation in 2002 and 2003 had been unchanged, at 2.1% and 2.3% respectively. The biannual Consensus Economics forecast of average inflation over the next ten years had fallen from 2.3% to 2.2% between April and October.

A21 The Merrill Lynch index of investment-grade sterling corporate bond spreads had fallen by around five basis points since 9 October, but yields had risen by around 15 basis points, reflecting the rise in nominal rates.

A22 The sterling effective exchange rate had depreciated by 0.9%, to 105.4, since the Committee's previous meeting. Movements in sterling against the dollar over the month had been broadly consistent with relative movements in nominal UK and US interest rates.

III Demand and output

A23 The ONS' preliminary estimate for quarterly growth of GDP at market prices in 2002 Q3 had been 0.7%, following 0.6% growth in Q2. Annual GDP growth had picked up to 1.7%, from 1.3% in Q2.

A24 The preliminary estimate for quarterly growth in service sector output in 2002 Q3 was 0.8%, following growth of 0.6% in Q2. Within services, quarterly output growth in the distribution, hotels, and catering sector had fallen to 0.3%, from 1.3% in 2002 Q2. Manufacturing output had fallen by 0.4% in September. In Q3 as a whole, manufacturing output had risen by 1.1%. Overall industrial production had risen by 0.4% in Q3, with a decline in energy sector output.

A25 Retail sales had risen by 0.4% in September. Quarterly growth in retail sales in 2002 Q3 had been 0.7%, compared with 1.7% in 2002 Q2. The Confederation of British Industry (CBI) Distributive Trades Survey had pointed to a pick-up in annual retail sales growth in October. Private new car registrations in the year to October had fallen by 6.1%.

A26 The Nationwide house price index had risen by a further 1.4% in October, with the annual inflation rate rising to 24%, from 22.2% in September. The Halifax index had risen by 4.7% in October, with the annual inflation rate rising to over 30%.

A27 The GfK consumer confidence aggregate index had fallen back slightly in October but, after allowing for seasonal factors, had remained around the high levels seen for much of this year.

A28 The British Chambers of Commerce (BCC) survey had shown a slight decline in investment intentions in the service sector in 2002 Q3, although the survey balance had remained close to its long-run average. The BCC survey had also shown a slight decline in capacity utilisation in the service sector. The CBI Quarterly Industrial Trends Survey for 2002 Q3 had shown a marked decline in investment intentions, with the balance falling to -25, from -13 in the previous survey. The BCC survey, by contrast, had shown a slight pick-up in investment intentions in the manufacturing sector,

with the balance rising to +10, from +7 in 2002 Q2. This survey balance had also remained close to its long-run average. The CBI survey had not pointed to a significant change in capacity utilisation in the manufacturing sector, while the BCC survey had shown a slight decline.

A29 Business confidence in the service sector had eased, according to the BCC survey, although the survey balance had remained close to its long-run average. According to the CBI Industrial Trends Survey, business confidence among manufacturers had fallen sharply in 2002 Q3, with the survey's optimism balance falling to -19, from +4 in the 2002 Q2 survey. This decline in confidence had not been mirrored in the equivalent BCC survey, which had actually shown a slight rise in business confidence among manufacturers.

A30 The BCC survey had pointed to a slowdown in demand growth in the service sector. The balance for domestic orders had fallen to +12 in Q3, from +19 in Q2. The CIPS services survey had shown continued growth in business activity in October.

A31 The CBI manufacturing survey had shown a decline in the total new orders balance in Q3, which had eased to -16, from -11 in Q2. But manufacturers' expectations about output growth had remained positive, with a balance of +8. The BCC domestic orders balance had eased only slightly in Q3, to +8 from +9 in Q2. The CIPS manufacturing survey for October had pointed to a rise in new orders, although the index had fallen from 52.1 to 51.3. Similarly, the output balance had shown growth in manufacturing output in October, despite falling back slightly to 53.1, from 53.7 in September.

A32 The Bank's Agents had conducted a survey of around 175 firms, covering retail goods, motor vehicles, financial services, and consumer and leisure services. Respondents had been asked how they expected the next six months to compare with the previous six, in terms of growth in value and volume of sales to individuals, and prices charged to customers. Companies covered by the survey had a total turnover of £54bn.

A33 Weighted by turnover, the majority of respondents in each of the main sectors had expected that growth in the value of sales to individuals over the next six months would be the same or slightly lower than in the previous six months. Retail respondents had cited greater economic uncertainty as the reason for expecting slower growth. There had also been some examples where respondents had expected slower growth in housing market activity to affect sales of furniture. Among consumer and

leisure services respondents, those catering for overseas tourists had been more likely to expect sales growth to slow than those catering for the UK market.

A34 Just under 40% of respondents had expected no change in prices charged. However, for motor vehicles, a far higher percentage of respondents had expected prices to fall, albeit only slightly in most cases. Competition for sales in a falling market had been expected to lead to price-cutting promotions.

A35 Just over three quarters of respondents expected growth in sales volumes to be higher or the same in the next six months compared with the previous six months. This response had appeared surprising given the responses to the questions, indicating slower growth in sales values and rising prices. A possible explanation, which had been supported by anecdotal evidence, was that consumers were trading down in their purchases, so volumes and prices could increase without a corresponding increase in value of sales.

IV The labour market

A36 According to the Labour Force Survey (LFS), employment had risen by 19,000 in the three months to August, compared with the previous three months. This had been weaker than the rise of 92,000 in the previous non-overlapping quarter. The rise in employment had been more than accounted for by part-time employment (up 91,000). The working-age employment rate was 74.6%, unchanged on the previous quarter but up 0.1 percentage points on a year earlier.

A37 Total weekly hours had fallen by 1.4% in the three months to August compared with the previous three months, and had fallen by 1.2% on the previous year. Average hours had fallen by 1.6% in the latest quarter, and had been 2.1% lower than a year earlier. Average hours worked by both full- and part-time workers had fallen by over 1% in the three months to August.

A38 The overall CIPS employment index had risen a little in October compared with the previous month, but it had remained below the no-change level of 50, indicating that employment had been declining less rapidly. The BCC survey had indicated that a substantial majority of firms in both manufacturing and services were still trying to recruit staff, while surveys of employment intentions in Q4 had indicated little change in employment growth.

A39 Recruitment difficulties in the service sector in Q3, as measured by the BCC survey, had been little changed, while the balance of firms reporting recruitment difficulties in the manufacturing sector had eased a little in Q3, following a rise in Q2.

A40 LFS unemployment had fallen by 5,000 in the three months to August, but had been up 46,000 on a year earlier. The unemployment rate had remained unchanged at 5.2% in the three months to August. Over the same period, claimant count unemployment had fallen by 600, and it had fallen a further 200 in September. Working-age inactivity had risen by 26,000 in the three months to August, and the rate had remained unchanged at 21.2%.

A41 Headline whole-economy annual earnings growth, as measured by the Average Earnings Index (AEI), had been 3.8% in August, down 0.1 percentage points from July. Headline earnings growth in the private sector had decreased by 0.1 percentage points, to 3.9%. In the public sector, headline earnings growth had fallen by 0.2 percentage points, to 3.4%. Actual whole-economy earnings growth had fallen from 4.1% in July to 3.6% in August. Whole-economy regular pay growth (not seasonally adjusted) had declined from 3.8% in July to 3.4% in August. Bonuses had been growing broadly in line with regular pay for the second consecutive month, and so had made no contribution to average earnings growth in August.

A42 The Bank's twelve-month AEI-weighted whole-economy mean pay settlement for September had been 3.0%, unchanged from the August figure.

V Prices

A43 Sterling oil prices had fallen by around 15% since the October MPC meeting, and were also lower on average in October than they had been in September.

A44 Manufacturing input prices had risen by 0.1% in September, mainly reflecting an increase in the price of crude oil. Annual input price inflation had risen in September to -1.0%, from -1.9% in August. But the CIPS manufacturing survey had continued to suggest that input price pressures might be subdued going forward. The input price balance had fallen for the third consecutive month in October, to 49.6, from 50.7 in September.

A45 Manufacturing output prices excluding duties (PPIY) had risen by 0.1% in September, while the annual inflation rate had remained unchanged at 0.4%. Survey data had continued to point to downward pressure on output prices going forward. Although the expected output price balance from the CBI Quarterly Industrial Trends survey had risen, it had remained negative at –8 in October.

A46 Annual RPIX inflation had risen by 0.2 percentage points, to 2.1%, in September. Within this, annual goods price inflation had risen to –0.9%, from –1.1% in August, and annual services price inflation had risen to 4.8%, from 4.6%. Annual RPIY inflation had also risen by 0.2 percentage points, to 2.0%. Annual RPI inflation had risen by 0.3 percentage points, to 1.7%, in September, while annual HICP inflation had been unchanged at 1.0% in September.

VI Reports by the Bank's Agents

A47 The Bank's regional Agents reported that growth in retail sales had continued to ease, albeit from a rapid rate. Demand for new cars and sports and leisure clubs had levelled off. However, travel companies had reported that demand for short breaks had remained strong. Banks and building societies had continued to report strong growth in demand for consumer loans and mortgages, and spending on big-ticket items such as electrical products had remained buoyant outside London. Overall, Agents had judged that, although growth in consumer spending was slowing, there had been no sign of any serious retrenchment by consumers.

A48 All Agencies had reported a slowing in demand for the highest-priced houses. But demand had remained strong for low-priced and mid-priced properties. Many Agencies had reported an increase in the number of properties coming on to the market, with vendors more prepared to accept offers rather than demanding the full asking price. Demand for buy-to-let properties had remained strong because of cash purchasers anticipating capital growth on the property, although excess supply of rental accommodation had reduced demand from some potential investors.

A49 Although there had not been widespread reports of falling output or orders, business confidence had remained weak. Heightened uncertainty amongst contacts about prospects had been attributed to geo-political tensions, stock market volatility and expectations of slower economic growth in the United Kingdom and abroad. Contacts had also become nervous about the effects on their own wage bills if large public sector pay rises were awarded. Larger companies, which typically had defined

benefit pension schemes, had also become concerned about the need to avoid showing too much of a funding gap in their FRS17 disclosures.

VII Market intelligence

A50 As at 6 November, interest rates implied by short sterling futures contracts had been broadly unchanged at shorter maturities, and a little higher at longer maturities, than on 9 October. The rate implied by the June 2003 contract was one basis point lower, at 3.91%, and that implied by the December 2004 contract ten basis points higher, at 4.87%. Implied rates had increased early in the period, in part reflecting rises in equity prices and some stronger-than-expected data, such as RPIX. In the second half of the month, equity prices had held on to most of their gains, but implied rates, particularly at shorter maturities, had fallen back in response to the release of the October MPC minutes and some weaker-than-expected data, such as the University of Michigan and Conference Board US consumer confidence surveys, and the ISM manufacturing survey.

A51 Economists polled by Reuters between 29 and 31 October had attached mean probabilities of 55% to no change in the Bank's repo rate, 43% to a decrease of 25 basis points and 2% to a decrease of 50 basis points. The proportion expecting the Bank's repo rate to be 4% at end-2002 had fallen to 50% from 65% a month ago, and the proportion expecting that the rate at end-2002 would be below 4% had increased to 47%, from 35%.

A52 Since the Committee's previous meeting, sterling had fallen by 0.9% on an effective basis; it had appreciated by 0.1% against the dollar and depreciated by 1.0% against the euro. Reflecting the relative stability of exchange rates, implied volatilities had fallen over the previous three months, to close to the historical lows seen in April 2002.